"For free, he's taught all of us what we try to do."

Tom Russo, explaining to the CFA dinner why he came to Omaha each year

There's no escaping the fact that attending the Berkshire Hathaway annual meeting in Omaha is, for a value investor, every bit as much a pilgrimage as a journey to Rome or Mecca is for a Catholic or a Muslim. It is awash with the ephemera and trinkets that have been a part of the pilgrim experience since before Chaucer's time. One presenter at the Value Investor Conference noted in mock surprise, "I went to the bookshop in Omaha airport and it seems every book is on Warren Buffett!" A meal at Gorat's (Buffett's favourite steak restaurant) is mandatory and if you want a table over the weekend of the meeting you should book as soon as they start taking bookings. (I stopped in for lunch during the week.) Other sacred sites are the Nebraska Furniture Mart and Borsheims, both wholly owned businesses of Berkshire Hathaway and the latter the largest jeweller in the US after Tiffany & Co.

Having said that, the fact that a large portion of the world's value investor population is drawn to Omaha every May means that there is a vast pool of talent for conference organisers to draw on. There are two major value investing conferences in Omaha around this time. I chose to go to the one being held on the two days prior to the Berkshire meeting. It was capped at about a third of the size of the larger one held over the two days after the meeting, there was a significant overlap of presenters and, importantly for a value investor, it was cheaper, being hosted by the University of Nebraska instead of a private promoter.

Almost without exception there was at least something of real value to be gained from every one of the more than a dozen presentations. I really don't know that I've ever been to a conference where I have been able to say that before.

I won't try to recap everything that was said over those few days, but thought I'd provide you with a summary of some of the recurring themes as well as some of the more memorable exchanges to give you a flavour of the weekend.

Some recurring themes at the Value Investor Conference:

Economic moats.
Classical economics states that any outsize profits a business is able to earn will inevitably be eroded over time as competitors are attracted to that market and the ensuing competition drives down prices. The exception is where a business has an economic moat (a sustainable competitive advantage) and is able to maintain healthy margins due to a structural advantage. This may be a cost advantage, such as location for a quarry that is selling to a local area. Google and EBay have each built economic moats through their “network effect”. Coca Cola has an economic moat by virtue of its brand. A simple way to think about whether a business has an economic moat is to ask yourself the question, “If I had an unlimited amount of money could I successfully compete with that business or put it out of business?” If the answer is “no”, then chances are it has a sustainable competitive advantage. Businesses like that are gold.

Berkshire Hathaway has had its corporate headquarters over one floor of Kiewit Plaza in downtown Omaha since 1966.

Developing world consumption.
As income levels in the developing world rise so too will the appetite for consumer products that we take for granted in the developed world. Whilst the China growth story is currently built on investment in fixed assets such as roads and buildings it will increasingly be predicated on consumer spending. This will mean they will be buying less iron ore and more food, beverage and personal hygiene products.

Companies with an ability to reinvest their cash flow at a high rate of return.
It is one thing for a business to be able to generate excess returns on its capital. It is another for it to be able to reinvest its cash flows and get those same high returns. (Blackmores is one business many clients are invested in which has consistently, over more than a decade, reinvested earnings at returns of around 30%.) The local quarry may have excellent margins which deliver it a high return on its invested capital, however it probably has little opportunity to reinvest that capital in a way that will generate similar returns for the business. In such situations the best thing for the business to do is probably to deliver those cash flows to its shareholders.

Three desirable characteristics
Many presenters touched on the same three fundamental characteristics they seek in a business - outstanding financials (return on capital, margins etc), great (trustworthy) management and attractive price – that one presenter distilled to, “great business, great people, great price”.

Price matters.
Irrespective of the quality of the business you invest in, the principal determinant of the return on that investment will be the price you pay for it.

Don't listen to the chatter

Lauren Templeton described how her uncle, renowned investor Sir John Templeton, when asked why his investment record improved after he relocated to the Bahamas replied, "I think it's because I get the *Wall Street Journal* three days later."

Berkshire Hathaway Meeting

For three hours in the morning and a further two and a half hours after lunch Warren Buffett and Charlie Munger (the Chair and Deputy Chair of Berkshire Hathaway) sat at a table at the front of the large auditorium and answered 69 questions from shareholders and insurance analysts. Their value investing message is a pretty simple one and so there was not a lot of information that could not be gathered from transcripts of past meetings and Mr Buffett's annual letter to shareholders. What you don't quite get from the transcripts is the interplay between the two of them, the folksy delivery of Buffett and the dry, caustic and gravely pronounced judgement of Munger (an old rich man who doesn't seem to care who he offends). What is particularly impressive is their ability to get to the kernel of an issue.

The queue outside the CenturyLink Centre shortly after the public car parks opened at 5.00 am Saturday morning.

They discussed everything from the "Buffett Rule" – a reform to the US tax system promoted by Buffett and adapted by President Obama whereby anyone earning over a million dollars would be required to pay at least 30% tax – to insurance, gold, regional media and China.

The Buffett Rule

In defending the Buffett Rule, Warren Buffett stated that the 400 largest incomes in the US averaged $270 million a year. Of these 131 paid less than 15% tax and 31 paid less than 10% tax. He says that he simply wants to restore the tax system to around where it was in the early 1990s.

One shareholder stated that his 84 year old father wouldn't buy Berkshire Hathaway shares because he disagreed with the "Buffet Tax". Wouldn't it be better if Warren just kept quiet for the good of the company? Buffett replied, "We didn't, and our CEOs don't, revoke our citizenship when we take on the job. We didn't decide to put our citizenship in a blind trust. I don't think that some 84 year old man should be making investment decisions based on my politics. Sounds to me like he ought to own Fox."

Charlie complained, "Warren's view on tax has diminished my popularity at my country clubs," to which Buffett replied, "If it stops him hanging around country clubs that's a good thing."

The early start was rewarded with a prime position for the meeting overlooking the stage.

Business Schools
"I would have a course on how to value a business and a course on how to think about markets. If you buy businesses for less than they're worth you're going to make money."

Insurance
"Separating the random from new trends isn't easy. We tend to assume the worst."

"In the last few months we have written a lot more business in Asia, Australia, New Zealand [because of the higher premiums]. The New Zealand effect per capita was equivalent to 10 Katrinas. Everyone re-evaluates the situation and we are ready to take out big limits if we can get the right price."

Renewable Energy
"Eventually we are going to have to take power from renewable sources. It is wise to use subsidies to get that started."

"How are you feeling?" (Buffett was diagnosed with prostate cancer a couple of weeks before the meeting.)

"Great. I'm eating properly (taking a large bite of peanut brittle).I have four doctors. At least a few of them own Berkshire Hathaway... Maybe I'll get shot by a jealous husband." Charlie adds, "I'm a bit jealous of Warren for all the sympathy he's getting. I probably have more prostate cancer than he does. I don't let them test for it."

Markets
"The stock market is the most obliging money making thing in the world. Because you don't **have** to do anything. The rules are stacked in your favour. As long as you don't turn the rules around and start acting like the drunken psychotic."

This echoes a remark Buffett made in an extended interview in February. "All you have to do is sit there and wait until something is really attractive that you understand and you can forget about everything else. That is a wonderful game to play in. There is almost nothing where the game is stacked in your favour like the stock market. And then what happens is people start listening to everybody talk on television or whatever it may be or read in the paper and they take what is a fundamental advantage and turn it into a disadvantage. There's no easier game than stocks. You just have to be sure you don't play too often."

Glenn Tongue of T2 Partners, a long standing and large shareholder in Berkshire Hathaway, asked why the market price of Berkshire has languished while the value of its portfolio and businesses had risen over the past year. It was clearly intended as an opportunity for Warren and Charlie to talk up their mutual book. Warren turned the question over to Charlie who refused to oblige. "I would say it is the nature of things that the market does not always do what you want it to do. I think you are probably not that welcome in this room if short-term orientation is what turns you on", followed by the thunderous applause of 30,000 people in an enclosed stadium. (I'm guessing he immediately regretted asking that question.)

Retail
When asked how he felt Amazon would affect Berkshire Hathaway's businesses, Warren Buffett pointed to the continued growth in earnings of Berkshire's diverse retail holdings, before Charlie Munger cast a pall over the meeting, "I think it will affect hugely a lot of people. I think it will be really terrible for a lot of retailers. Not slightly terrible. Really terrible."

On how to value a declining business
Charlie started off by noting that, "They're not worth nearly as much as growing businesses." They then went on to remark that Berkshire Hathaway itself had been built on a number of declining businesses – a Baltimore department store, a New England textile mill (from which it took its name), a trading stamp company and various newspapers – but that the breakthrough had come when they stopped sinking capital into these businesses and directing the cash flow they generated to other businesses that were able to better employ it.

On what they were NOT buying
Warren Buffett said, "I can't recall a time in the last 30 years when we've bought a new issue [IPO or new float]." The seller is choosing the time to bring it to market, they are actively promoted and they pay a healthy commission to the brokers promoting them. "What's the chance of that being the best value opportunity available in the market?"

Charlie Munger echoed the point. "If it's got a really large commission in it, don't read it. The chances someone is paying a high commission to give you a big advantage is **really** low."

Regulation of markets
Charlie, "Alan Greenspan overdosed on Ayn Rand when he was young. If an axe murder occurred in a free market he probably thought it was OK."

The trip home had an unexpected detour via Hawaii and was a day late after a passenger took ill over the Pacific. As they say, "when you get lemons, make lemonade".

Executive Compensation
A number of questions touched on how they motivated the managers of their operational businesses. Warren Buffett pointed out that there were financial and non-financial incentives and, as the operational managers are often the founders of businesses bought by Berkshire with no financial need to work, he and Charlie have thought a lot about why they themselves do what they do. "We get the opportunity to paint our picture every day and it's a painting that will never be finished. And if we had someone looking over our shoulder saying, 'Why don't you use more blue paint?' we might tell them what to do with the paintbrush. And that's how we think they feel about it. Compensation's never been an issue."

Sovereign Debt
Charlie summed it up quite succinctly, "Everyone wants fiscal virtue, but not quite yet." He went on to say that there is a place for stimulus but that he wished it was spent on things that would really be useful over the long term, like infrastructure.

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