Ist June' 2018

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BizNotes

FOR PRIVATE CIRCULATION

M O N T H L Y V I E W

FROM THE FUND MANAGER DESK

Crude Reality?

Speculative surge with no structural support, yet doesn't fail to fuel end-of-the-world worries for Indian macro!!

Hedge funds are having a field day. Perfect setting for them to spin off a speculative spike on the oil price. All they need is some semblance of supply shock. It hardly matters for them that the shock is only for short-term or it is only from a marginal swing in supply. It doesn't even matter that there is a OPEC daddy who is sitting on tons of supply (currently on self-inflicted supply cut), waiting to pounce if the price point breaches certain level. The fact that the swing producers like shale gas sharks can unleash supply on short notice hasn't failed them from their ferocious attack on the fossil price. They know that they have enough financial ammunition to magnify minions into monsters - which is precisely what they have done with the marginal supply issues that have erupted from Iran sanctions, Venezuelan political hiccup and the temporary lull in shale gas drilling.

Speculative spook:

Hedge funds know that their luck wouldn't last long as it is difficult to build a long-term bull case for oil given the strong supply fundamentals and long-term demand uncertainty on emerging Electric and Hybrid technologies. While funds are having fun while it lasts, unwittingly they seem to have spooked markets like India which is heavily reliant on oil imports.

Last two weeks have been busy time for both financial and political commentators in India. They are busy in endless debates on how oil has roiled the markets or oil is increasingly foiling the future of this administration (Govt). Take the case of rupee or yield and how they have been spooked by this spoof. Look at how, with their spiced up spreadsheets, these

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financial commentators spruce up their (mis)projections on currency and interest rates to create a vicious scare on rupee and yield. Persistent FII selling on emerging markets exit (on rising US Fed rates) couldn't have come at a worse time.

All of them know it is more of entertainment value than anything material as oil surge is more transient and less structural. But no harm in having fun while it lasts. But for one community, this entertainment is likely to be an enriching one. That is venerable value investing community. With spooked markets throwing significant value opportunities, they are on mission mode to cherry-pick stocks at salivating prices. Scare works in a strange way in stock markets. It doesn't shake the larger ones as much. But for small and midcaps, it is a different story. They get slaughtered mercilessly by this vicious scare of rising crude and falling currency. Though the Sensex looks deceptively steady, the broader small and midcaps are under severe strain, thus providing a great stock-picking opportunities for value investors.

In the last couple of days, crude has cooled a bit though, on the prospects of production hike from OPEC, rise in US inventories and jump in shale gas rig counts. This is not something unexpected, though hedge funds will use all their money muscle to keep the hysteria going. Only time will tell whether this fall in crude prices is temporary or a more sustainable one. It is anyone's guess how the price will swing in the short-term. That said, there is much less fundamental case for crude to be high in the medium to long-term.

Happy Value Investing!!

ArunaGiri. N

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CORPORATE NEWS

- A subsidiary of **Granules India** has received approval from the US health regulator for **Methylergonovine tablets**, used for prevention and control of postpartum haemorrhage.

- **Divi's Laboratories** said its unit at Choutuppal in Telangana has undergone successful inspection by the US health regulator with no observations. The company's unit-I at Choutuppal has had an inspection by the **United States Food and Drug Administration (USFDA)** from May 14-16, 2018.

- **Yes Bank** has recovered 66% of the original claim filed for Rs 3.25 bn after the sale of Bhushan Steel to Tata Steel under the insolvency resolution process.

- **UltraTech Cement** has said it will acquire the cement business of B K Birla firm **Century Textiles** through a share-swap deal. Under the arrangement UltraTech will merge Century Textiles' 13.4 million cement capacity with itself, taking UltraTech's capacity to 105.9 million tonnes per annum (mtpa) in the domestic market, and consolidate its leadership position in the Indian cement industry.

- **JK Paper** will make an investment of Rs 14.5 bn to expand capacities at its Gujarat plant. The investment will go into expansion of packaging board capacity by up to 200,000 tonnes and pulping facilities by up to Rs 160,000 tonnes.

- The government is considering allowing 100 per cent **foreign direct investment (FDI)** in **insurance intermediaries** with a view to give a boost to the sector and attracting more funds.

- **Tyre makers in India** have lined up an aggressive capacity expansion plan to meet the growing demand from automobile manufacturers and replacement market after fully recovering from demonetization and the GST. A total of Rs 136.4 billion is expected to be pumped in by the tyre makers over the next 7-10 years.

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- **Walmart Inc.** has announced the purchase of a majority stake in **Flipkart** in a deal that will value India's largest online retailer at more than $21 billion, making it the world's biggest ever e-commerce acquisition.

MACRO NEWS

- **ICRA** expects **GDP growth** in January-March 2017-18 at 7.4% on account of good rabi crop harvest and improved corporate earnings, up from 7.2% in the third quarter.

- With an aim to boost renewable power generation, the government announced a **National wind-solar hybrid policy**, which seeks to promote new projects as well as hybridization of the existing ones. The government has set an ambitious target of achieving 175 Gigawatt (GW) of installed capacity from renewable energy sources by 2022, which includes 100 GW of solar and 60 GW of wind power capacity.

- Aided by a normal monsoon last year, **India's production of food grains** touched a record 279.5 million tonnes in 2017-18, the agriculture ministry said in its third advance estimate of crop production released.

- **Bank deposit growth** fell to a five-decade low in fiscal year ended March 2018 as the demonetization bonanza withered away and the lure of other savings instruments such as mutual funds and insurance eroded banking competitiveness.

- **SEBI** has asked listed companies to split the post of Chairman and Managing Director by April 2020. It has also made it compulsory for them to have six independent directors on board, including a women director.

- Weighed down by the **Reserve Bank of India's (RBI's)** new rules on restructured assets, domestic banks, both public and private, added over Rs 1.3 Trillion in **gross non-performing assets (NPAs)** in the fourth quarter ended March. Provisions and contingencies, amounts set aside for NPAs, also rose to Rs 1.4 Trillion in the final three months of 2017-18.

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- As per **Indian Sugar Mills Association (ISMA)**, the country's sugar production had surpassed 31 million tonnes (MT) till April 30, nearly 1.5 MT more than what the sugar industry officially had forecast in March.

- **The government** said it has finalized the methodology for rationalization of coal linkages for **independent power producers (IPP)**. Under the new methodology, dry fuel can be supplied to IPP plants by a coal company other than the one with which they have signed the pact.

FUNDS FLOW DATA

Data as on 28th May 2018		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	(8571)	(1173)
DII	11736	57489
Total	**3165**	**56316**

DEBT & FOREX MARKET

Data as on 29th May 2018			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.8	7.8	7.7
Re/ US $	67.9	66.7	65.2

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MARKET VIEW*

May stands for Mayhem?

Rewind back to May'2013. One would find a striking similarity to what we witness now – ferocious fall in small and midcaps triggered by vicious fall in currency, sharp rise in ten year yield, incessant FII selling, rising fears on twin deficits (current account deficit and fiscal deficit). Underlying cause for the mayhem in both May(s) can't be more similar. Back then, it was taper tantrum i.e. the term used for unwinding of bond buying program from Fed (withdrawal from quantitative easing). Fast forward to now, it is the expected acceleration in Fed rate hikes coupled with some unexpected jitters from crude that have caused the slump in small and midcaps.

But the interesting aspect of 2013 was, within few months, that is, well into taper tantrum, markets recovered with Rupee recouping much of its losses on return of FII buying. It was not so much of "taper" (unwinding) that caused the trouble, but the sheer prospect of such "taper" coming did more damage. In hindsight, going by the sharp rebound in the markets in six to eight months, taper tantrum was a terrific opportunity for anyone who cared to ignore the macro noise and focused on stock picking and portfolio building. Needless to say, current Fed induced fear, is a fantastic opportunity for seasoned stock pickers who have the wisdom not to time the bottom and have the stomach & nerve to digest the notional mark-to-market losses in the interim.

> **"It is time to invest, not to time the bottom. When it is raining gold (in the context of small and midcaps), it is time to reach for the buckets"**

But unfortunately, few learn from history. Even those few who learn, most take comfort in the breathless commentary in business channels that focuses on the short-term gyrations than to switch-off from those endless chatter and take the most important action, that is, portfolio building on the ground. Those exceptional few who brave the volatility to build portfolio, needless to say, will reap rich dividends not too far in the future.

We stay away from giving market outlook (except reporting the consensus view) as we believe that the short-term market movements are function of innumerable rational and irrational parameters and hence any attempt to predict the next market move would be a futile exercise. Hence, we would like to qualify the above consensus view on outlook with a clear caution that TrustLine does not have any specific view on the outlook and does not necessarily subscribe to that.

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VALUE EXTRACTS

- In this section of the newsletter, we attach an extract/write-up that we believe can add value to the readers from the "***VALUE INVESTMENT***" point of view or others that offer interesting perspective.

- Enclosed section carries an interesting article titled ***"Notes from Berkshire Hathway AGM 2018"*** by **Adam Blum**.

"Investing is a strange business. It is the only one we know of where the more expensive the product gets, the more customers want to buy them."

- Anthony M. Gallea

Notes from Berkshire Hathway AGM 2018

Introduction – Perspective on how to think about investments

"Here's some personal history, with *The New York Times* front pages from March 10-12, 1942. You can see I'm a little behind on my reading. This was three months after we got involved in World War II, and we were losing, and headlines were full of bad news about the Pacific. The price of the newspaper was 3 cents, incidentally. On March 10, the stock market was reflecting this news. And I'd been watching City Service preferred stock for a while. It was $84 a share the previous year and $55 a share at the beginning of 1942, and then in March it was down to $40 a share. On the 11th, I told my dad I wanted to buy three shares. That was all the money I had at the time – I was only eleven years old. So he bought the shares for me. On the next day, the stock market was down 2.28% and broke 100 on downside, which is the equivalent of a 500-point drop. I was in school wondering what was going on. My dad had bought me the stock at $38.25, which was the high for day, and it was down to $37 by the end of day. Even though the war looked bad until the Battle of Midway, the stock did well and was called for over $200 a share by City Service. But I'd sold at $40 for $5.25 gain after watching it go down to $27. What's the point? Imagine myself on March 11, 1942.

Things were looking bad, but everyone knew we'd win the war, and the system had been working well since 1776. Investing $10,000 in an index fund in 1942 to own a piece of American business would now be worth $51 million, and you wouldn't have had to do anything. You wouldn't have had to understand accounting or look at quotations. All you had to do was figure that America would do well over time, and American business would in turn do well and overcome difficulties. You didn't have to pick out winning stocks or know when to buy or sell. The overriding question is, 'how is American business going to do over your investing lifetime?' If you had taken $10,000 and listened to the prophets of doom and gloom and bought 300 ounces of gold instead, today that still would be 300 ounces of gold. You could go down to the safety deposit box and look at it and fondle it, and it wouldn't produce anything. That gold would be worth $400,000 today. If you'd decided to go with a non-productive asset versus a productive one, it is one hundred times the value difference.

Every dollar earned in investing in the American business was matched by less than a penny gained by investing in a 'store of value' like gold over the same period. We have the greatest tailwind you could ever imagine in this country. There's no comparison trying to jump in and out of stocks and pay investment advisors and invest in non-productive assets. If everyone had just bought in, your friendly stock broker would've starved to death, and you could've gone to his funeral to atone for it. You do not have to know about accounting and terminology and what the Fed is doing. It's about a philosophy and forgetting what you don't know how to do."

Q – Will Berkshire still be an attractive buyer for businesses looking to sell in the future?

Warren: "[Former Heinz CEO] Tony O'Reilly said that the responsibility of CEO is to search the organization and find the person with all the successor qualities, and fire the guy. The reputation of Berkshire as being a very good home for companies, particularly private companies, is not dependent on me or Charlie. There will be a little testing period for whoever takes over, but we have money to do the deals and will have the money, and others can see how our subsidiaries operate. If things get bad enough, people will be calling us. And they'll be dependent on Berkshire and not on me. My big winning personality is not delivering lately, as phone isn't ringing off the hook, so maybe the next guy will be better. But the reputation belongs to Berkshire and not to me. We absolutely are the first call and will continue to be for businesses who want a good home. It's already happening with subsidiaries or managers getting the calls instead of Charlie and me."

Charlie: "99% of the changes of control in business happen at an auction run by an investment banker, and then the company is leveraged to the gills and re-leveraged. All the money comes from endowments and pension plans, and sooner or later this won't work very good, and there'll be an unpleasant episode. And we'll be around and in good shape at that time."

Warren: "One fellow came to us who had seen a family business that had a transition after the death of the owner, and people were taking advantage of the widow, and this fellow decided he didn't want to sell his company to a competitor who was his logical buyer, because the buyer would fire everyone, and he didn't want to sell to private equity, as he didn't want the company to be leveraged and resold later. And he wanted to keep running it himself. He said, 'it isn't that you're such a great guy, it's just that you're the only one left.'"

Q –Wells Fargo scandal and analogy of when it's better to change vessels than to patch leaks

Warren: "Wells Fargo proved the efficacy of incentives and had the wrong incentives, but the much greater error was ignoring the fact that they had a faulty incentive system. The cardinal sin at Berkshire is not doing something about it once you know. We can't have 387,000 employees and think everyone is behaving like Ben Franklin. Clearly, we don't want to incent anything bad, and when we find what's going on, we have to do something about it, and that's the key. Wells Fargo and Salomon didn't do it. It happened with Amex in 1964 and the same with half of Geico for $40 million, because someone didn't have enough reserves in the 1970s. The motive was to please Wall Street. Both companies emerged and came out incredibly stronger. So many investments have come from this. All the big banks have had troubles, and I see no reason why Wells Fargo, from an investment or moral standpoint, is inferior. They made a big mistake, and it cost them. I like it as investment, and I like [CEO] Tim Sloan. Charlie always says, 'an ounce of prevention is not worth pound of cure, it is worth a ton of cure.' We attack problems especially when everything is going fine.

Charlie: "Wells Fargo will be better going forward. Harvey Weinstein has done a lot for improving behavior too. It was clearly an error, and they're acutely aware and embarrassed and don't want to have it happen again. They're likely to behave the best of all the banks in the future." Warren: "Look at that 1942 newspaper's classifieds with the help wanted separated between male female sections. People make mistakes. They do a lot of dumb things in this world. Geico was a lot more stupid than Wells Fargo and had the world by the tail, and now Geico has 13% market share. With Amex they asked the auditor at the annual meeting, 'how much did we pay you, and how much extra would it have been to go over to Bayonne to check how much oil was in the tanks?' There was a tiny operations guy calling in saying something was going on, and they didn't want to hear of it, but what emerged was a great company. You will get bad news, and what's important is to do something about it. Charlie has performed a lot of services for us related to this that you don't know about."

Q – An accountant asks about why they're upset with new mark-to-market rules for income statement

Warren: "The market value of our securities is now being reflected each period on our income statement. This is inconsistent. This $170 billion of partly owned companies we intend to own for decades and expect to grow and mark its value changes already on our balance sheet. Is it fair to change to force the value changes to flow through on the income statement when all our private company holdings aren't accounted for this way? That would become an appraisal process. To run through an income account and mark our 60 private businesses to market would not show meaning in terms of net income being a real indicator of what was produced in that period and would be a great disservice. It's fine for marketable securities on the balance sheet, but the income statement creates major issues. If we were to sell half of BNSF, we'd receive more than what we carry the entire investment at. If we had to appraise it every three months, it would lead to manipulation."

Charlie: "A change in valuation always goes into net worth figures on the balance sheet already, and the questioner doesn't understand his own profession."

Warren: "He's not supposed to talk that way, but sometimes it comes out."

Q - Tariffs

Warren: "There's some jockeying back and forth, but I don't think either country [US or China] will dig into something that precipitates and continues any type of trade war. There'll be some back and forth, but we won't come out with a terrible answer."

Charlie: "Steel conditions were almost unbelievably adverse to American steel industry. Even Donald Trump can be right on some of this stuff."

Warren: "The President needs to be an educator-in-chief like FDR with his fireside chats communicating what needed to be done and was happening. Trade is difficult, as the benefits are not visible. We don't know what the costs of products and services would be if things were different. The negatives are very apparent and painful. Like the guy laid off from our shoe business in Maine who was very proud and a good worker and found out that his country was not competitive in shoemaking. Adam Smith and David Ricardo and all these benefits of trade make no difference when you have to retrain a 55-year-old. Politics are tough when you have a hidden benefit but a visible cost. The President has to explain how it hurts us in a real way and help us understand that that's the price individuals pay for the collective good. And we have to take care of the road kill in something collectively good. Society is acting through representatives to develop policies to get us the right economic result and not kill people in the process. Every time a baby is born, we take on an obligation for educating them. We take care of our young and old off the back of the people's productive years. It's been a tough sell to the little guy who made shoes in Dexter, ME or worked at the textile mill in New Bedford, MA or the steel mill in Youngstown, OH."

Q – On if they'd issue a dividend if they had over $150 billion in cash and nothing to buy

Warren: "We would figure out the most effective way to return capital at that time. It would be a repurchase if the price of our shares was not over intrinsic the value, which is better than a dividend. We try to do whatever makes the most sense but not with idea that we have to do something every day. Our B shareholders voted 47:1 against a dividend, though there's some self-selection of who becomes a shareholder. Our shareholders expect us to do whatever we think makes sense for all shareholders. Our directors own significant stock, and management does too, and all think like owners. We won't always be in a world of low interest rates and high private market prices, so some acquisitions will come about. It's very unlikely we'd pay out a big special dividend."

Charlie: "As long as the existing system continues to work as well as it has, why change it? We are capable of changing our minds if the facts change. We've done this several times but must say it's a little hard."

Q - What would they do differently if they had only $1 billion to invest? More emerging markets?

Warren: "We would find within the US' $30 trillion market that there are opportunities better by some margin than what we can find for $100s of billions but wouldn't rule out emerging markets. I used to buy small Korean stocks for fun in recent years on weekends. With a billion dollars, my first inclination is to comb through the US and maybe a few other places, but I wouldn't get into very small markets. Size, not geography is our problem."

Charlie: "I already have more stocks in China than you do as percentage of my assets, so I am with the young lady[questioner]. China is a better hunting ground. It's a younger market but still large."

Warren: "The markets work toward efficiency as they age. Like Japan with warrants being priced out of line thirty years ago, but after a while it disappears."

Q – Fifty-year view

Warren: "Berkshire in 2068? I don't know. We'll be based on certain principles but where that leads, we will find out. I hope and believe will be as shareholder oriented as any large company and look at shareholders as partners and that we'd do with the money what would do with our own and not seek an edge over our shareholders."

Charlie: "I want to talk to younger shareholders who inherited our stock. If you sell the stock, you're gonna do worse, so I would advise you to keep the faith. Some of that has already happened in many families."

Warren: "I will give his answer next time now that I see all that applause he got."

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Q – What impact will the increase in the number of T Bonds going to auction have?

Warren: "I don't know, and no one does, not even the Fed. Long-term bonds are a terrible investment at current rates. All our money waiting to be placed is in T-Bills (4-month maturity), and the rates on those have gone up lately, so we've made at least $500 million more pre-tax income on them this year than last year, because of rates. Long term bonds are taxed, so they're a 2.5% net return, and the Fed will do whatever is in its power to not give .5% a year inflation-adjusted, so we suggest sticking with productive assets by far. The bonds have trillions of dollars in the hands of people trying to fuss with which maturity is best to own, and we don't bring anything to that game."

Charlie: "It was unfair to reduce savings rates as much as they did, but they had to do it to fight the Great Recession appropriately. I was weird, and in my lifetime, it only happened once but it benefitted al the people in this room with the rise in asset prices including Berkshire stock. We are all a bunch of undeserving people and hope continue to be so."

Warren: "1942 war bonds cost $18.75 and paid out to $25 in ten years – that's a 2.9% return compounded. Even an eleven-year-old could understand that's not a good investment. The government knew significant inflation was coming. We had massive Keynesian behavior as the war forced a huge deficit where debt was 120% of GDP, and it was the great Keynesian experiment of all time, and we accidentally backed into it. It set us on a path of growth for all time. But T Bonds haven't been attractive ever since except in early 1980s , when they briefly offered a 30-year compounded 14% return. Every now and then something really strange happens, and the trick is to act."

Charlie: "I never had any war bonds since I didn't have any money during the war."

Q – Zero-based budgeting

Warren: "We do not expect our managers to be in a position with a lot of change. 'Why aren't you always thinking that way?' 3G has been in certain situations where primarily in personnel and other areas where expenses were not delivering value. And they made changes fast. We hope managers take the Geico way and add people only if it is productive. Geico has grown from 8,000 to 35,000 and increased its productivity. I can think of organizations where you can take a whole lot of people out like the tobacco companies of old that were so profitable and added all these people. Our managers do not submit budgets to me, and we have never had a company budget and don't even consolidate monthly figures. There's no reason to spend the extra time. We are the only company in the whole Fortune 500 who does this, but we don't do unnecessary things around Berkshire, and that's why a 3G finds opportunities."

Charlie: "We have thirty people at headquarters, and half are internal auditors. This is not normal. We have some losses because of it, but we lose huge disadvantages with meetings after meetings and bureaucracies, and that makes us more attractive to able-bodied company leaders. Our methods have worked so well that we're unlikely to change. I'd say we have subzero-based budgeting at headquarters. Bureaucracy is sort of like a cancer and functions like one. Our headquarters sets the example for our companies."

Q – Going direct in the small commercial insurance market

Warren: "We'll find out if we can be as successful as Geico in going direct. There's no question that anything that takes cost out of system is going to work over time. We are experimenting and will continue to take costs out of the system and offer the customer an equivalent product or better at a lesser price. We expect some mangers to fail and a few to succeed."

Charlie: "If it was easy, it would have happened faster. It wasn't easy in auto, but that's an old industry full of agency costs and wasn't efficient and took State Farm going captive then USAA and Geico and Progressive going direct in a consumer-friendly and direct way. The same thing will happen in commercial, but it takes an amazingly long time. The race is not to the swift or the battle to the strong."

Q – On healthcare

Warren: "The healthcare system has a moat against intruders, but that doesn't mean individual companies have moats. If we succeed, we're attacking the industry's moat and not sacrificing care. It's not about any company or component of the sector's moat. We will do our best but hope someone succeeds."

Charlie: "When democrats control both houses and the White House, we will get single payer healthcare, and it won't be friendly to PBMs, and I won't miss them."

Q – On moats

Charlie: "What Elon Musk said about the conventional moat is truly ridiculous. Elon says a conventional moat is quaint, and that's true of a puddle of water. It's ridiculous. Warren does not intend to build an actual moat even though they're quaint."

Warren: "The pace of innovation accelerated in recent years. There are more moats susceptible to innovation than earlier, but folks always attempt to do it. You have to always work to improve and defend your moat. Elon may turn things upside down in some areas, but I don't think he'd want to take us on in candy. There are some pretty good moats around. Being the low-cost producer is a terribly important moat. Technology doesn't always translate to the lowest cost. The technology at Geico has not brought down the cost, but its position among big companies is as a low-cost producer, and that's not bad when selling essential item."

Q – Tax bill impact

Warren: "What we saw in the first quarter under these rates is a reasonable guess of the impact of the tax bill, but we have firepower we haven't used, so we do expect our normalized earning power to increase over time, and if it doesn't, we are failing you. Most of our businesses' first quarters are not their strongest quarter, but we expect substantial capital gains coming from marketable securities. Many billions of dollars not shown are being retained by our investees, but one way or another will show in value."

Charlie: "Shareholders won't see another increase in net worth of $65 billion in a single year, but eventually another will come and then another. Be patient. The current situation is not disadvantageous except that we want to get more money out. These businesses will generate far more in earnings for us [Berkshire as a shareholder owning a piece of the businesses' earnings versus just factoring in the dividend payments as return on the investment] than in dividends. We like Apple and the airline stocks better than their dividends."

Q – Kraft Heinz and healthy food

Warren: "We don't want to give info on marketable securities. There are a number of items enjoying growing demand, and some vary by geography. CPG is still a terrific business in terms of ROI, but the population grows slowly. There's some room to experiment, but it's not a business with terrific organic growth and never has been. The returns on tangible net assets are very good at those businesses."

Q – Why never bought Microsoft stock?

Warren: "In earlier years, the very clear answer is stupidity. But since Bill joined our board and earlier because of our friendship, it would've been a mistake. If something happened, we would be targets of suggestions and accusations of having insider knowledge. We stay away from a few things just totally, because the inference would be drawn that we might've talked to someone about something. I told Ted and Todd a few things are off the list. As for Microsoft, both that and my stupidity have cost us a lot of money."

Charlie: "Part of theology is that a late conversion is better than never, and you've greatly improved yourself."

Q – Calculating intrinsic value

Charlie: "We would look for mispriced stock opportunities with less capital. I can't give a formulaic approach to intrinsic value and don't use one. I mix all the factors, and if the gap between value and price isn't attractive, I go onto something else. Costco at 13x earnings was a ridiculously low value because of the brand. I like the cheap real estate and the good competitive position, and even though it traded at 3x book, it was worth more. There was not a formula. If you want one, go back to graduate school, as formulas don't work."

Warren: "This is the longest we've gone in a meeting before Charlie says he prefers Costco to Berkshire."

Q – On Apple's buybacks

Warren: "$100 billion is a lot of money, or I used to think so. Apple has an incredible consumer product which you understand a lot better than I do, and they shouldn't buy in shares at all unless they're selling at less than what they're worth and have the money, and I don't see many attractive acquisitions for them. Deals are very hard to find that would be accretive to them at the $50-200 billion range, and we are delighted to seeing them buy back shares. We own 5% and may get to 6-7% from repurchases. This is an extraordinary product and ecosystem. I love the idea of growing our ownership without laying out a dime. They have to have a very extraordinary product and an enormously wide ecosystem and be extremely sticky and that sort of thing. They won't find acquisitions at a remotely sensitive price that make a lot of sense in terms of what have to pay and what they would get. Do they see a business they know everything about that they may or may not be able to buy at an attractive price? I would love to see Apple go down in price so we can buy more. This gets lost in all the discussions. Tim Cook can do very simple math and complicated math too on whether to buy shares or pay a dividend or buy a company."

Charlie: "Generally speaking, when companies go out hell-bent to buy other companies, they're worth less later. Plenty of companies have no better use of their cash than to buy back stock, but I don't approve of every buyback. Some people do it just to keep the share price up, which is insane and immoral, and other than that, its fine."

Q – Asked by an eight-year old girl about capital allocation (clearly her parents wrote the question)

Warren: "I'm certainly glad she's not nine-years-old. I am just sitting here thinking which of the 6 panellists we're going to bump next year. I thought I was doing well when I bought City Services at age eleven. We like efficient businesses that earn a terrific return on capital. We can't get more money deployed in capital light businesses at prices that make sense to us. Wouldn't it be wonderful to run railroads without trains and tracks and bridges and tunnels and a few things? We still love a business that takes very little capital and earns high returns, but the second-best choice is still a good choice.

Charlie: "I like the aspiration. What you're describing is a business that wants a royalty on the other fellow's sales. It's a good model, and no one could do it in everything. But returns on utilities and the railroad are quite satisfactory, and you're asking us to have perfection if you want all our money in Coke at a good price." Warren: "We haven't forgone any opportunity to buy capital intensive businesses. You definitely have a job in our capital allocation department."

Q - Cryptocurrency

Warren: "Non-productive assets remain that way. Gold at the time of Christ to now has a compound rate of a couple tenths of percent. These assets won't deliver anything other than supposed scarcity, but so what, what does it produce itself? All this is counting on someone else later on trying to buy a non-productive asset because they can sell it for a higher price. Think of raw land. The Louisiana Purchas was $15 million for 800 square miles, so we paid 3 cents an acre. That's a pretty good purchase of what was then a non-productive property. We can buy stamps like Bill Gross, but that's dependent on someone else buying from you. In the end, you make money on productive assets. You go based on what an asset will produce versus hoping tomorrow morning the price will be higher, and you need more people coming than going. And it can feed on itself for a while, but cryptocurrencies will come to bad endings. There are a lot of charlatans who are just trying to create things. People of less than stellar character see an opportunity to get rich, because their neighbour is, and neither understands it."

Charlie: "I like cryptocurrencies a lot less than you do. To me, it's just dementia. It's like somebody else is trading turds and you decide you can't be left out."

Warren: "To the extent we are being broadcast around the world, I hope that your comment doesn't translate."

Q – Benefits of being multicultural

Warren: "It's terrific. I never was good at learning languages. It is a great advantage over time to understand the cultures of other societies. The market system, modified as it may be between here and China, really does have a working invisible hand to improve the lot of future generations. Prosperity through one's own efforts and also through interactions with rest of world is great. Look at the Marshall Plan compared to the post-World War I disaster. People will be living better in the future and can't be stopped absent weapons of mass destruction."

Charlie: "It wouldn't do good to be fluent in both Chinese and English if you're a proctologist. If you're going to use it, you have to work in some interface between the two countries and can raise money one place and invest it in the other like Li Lu or be some kind of importer or trade specialist or something."

Warren: "Generally speaking, when being multicultural, you can be multidisciplinary, but you usually make more money in a single discipline unlike me and Charlie, so maybe be a proctologist."

Q – Cash needs for insurance

Warren: "We do not correlate or measure float and decide how much to leave in cash and fixed income. Float keeps growing, and cash has grown because competition for acquisitions has been much stronger (cheap debt and variety of factors). We are not tying cash to float. There's no way float can shrink in a short period. Structurally it can't. Float will grow for a while. It's amazing how much float we have all from that little building Jack Greenwald [of National Indemnity] picked that was near the tennis courts. Our cash has gone up a lot recently, $400 million a week absent float, which is comfortable, and we want to get it so more is going out in productive assets."

Q – Looking back at a Buffett Fortune article in 1999 thinking profits wouldn't be >6% of GDP but since 2008 profits have gone up to 8-10% of GDP

Warren: "The four largest companies by market value don't need any net tangible assets. They're not like AT&T, GM or ExxonMobil requiring lots of capital to produce earnings. American industry is much more profitable in aggregate over the last twenty years. Earnings on tangible net worth growth is due to fact that we have become an asset-light economy. We will earn even more with lower taxes. Carnegie built a steel mill and paid it off and then built another and so on. All enormously were capital intensive, and now money is in asset light and negative asset business. IBM has a minus tangible net worth – this is not the world we lived in thirty years ago, and I didn't see it coming. It hasn't changed the profitability of older, capital intensive industries though."

Charlie: "You didn't invest wrong but may've predicted wrong. You weren't very right on that one." Warren: "I was being wrong for the right reasons."

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Q – Ability to forecast success of one product versus another

Warren: “Amex went into the credit card business because of worries about what would happen to traveller’s checks. When they entered competition with Diners Club and Carte Blanche, they came in at a higher price with a centurion on the card. They had more value and got better representation. When someone would use the card, he looks like he’s JP Morgan versus the guy paycheck to paycheck. Ralph Schneider of Diners Club got there first but didn’t do much else. All kinds of colas came out over the years, but Coke really is the real thing. I wouldn’t take RC at half the price of Coke. A 6.5-ounce Coke sold for a nickel in 1900 and now is not much more, whereas in 1942 a newspaper was 3 cents. So, the enjoyment has gone dramatically way down on an inflation-adjusted level. Coke is a real bargain product. Just like with See’s – if a boy gave a box to a girl, and she kissed him, you lose all price sensitivity at that point. We like products where people feel like kissing you instead of slapping you. We are betting on the ecosystem of Apple products led by the iPhone but see characteristics that make me think this is extraordinary. After the Amex scandal in 1963, we worried about survival, but no one quit using the product.”

Charlie: “I have nothing to add except that if offered chance to go into Coke right after it was invented, we would’ve turned it down. It would’ve looked silly to us unless we drank it. We want to see how a consumer product behaves under lots of circumstances.”

Warren: “In Graham’s *Common Stocks and Uncommon Profits*, reading about the scuttlebutt method you can learn a lot just by using some shoe leather. These are called channel checks now. You can really get a feel for some products. It’s a good technique, and Ted and Todd do a lot of it and have others help them. Charlie does it with Costco. The product has enormous appeal to the constituency. They surprise and delight their customers, and there’s nothing like that in business. It’s a lot of the way home if you delight your customers.”

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Q – Looking abroad for more acquisitions

Warren: "We see some outside the US, and thank goodness we saw Iscar in Israel when Eitan wrote us the letter, but we're still not as far along as we would like around the world in terms of expansion. In the US, all the large deals think about Berkshire, but elsewhere we are not as embedded. They know about us and know we have a lot of money, but the results haven't been that great. I hope tomorrow to get a call from you name it wherever it may be and get an opportunity to do it. Our experience in Israel has been terrific."

Charlie: "These global acquisition markets are driven by LBOs and whatever they call it 'strategic,' and I usually translate that into barnyard language – it's so much craziness that of course it's hard to do it. Even the LBO firms are getting nosebleeds from the valuations. We've never made 'strategic' plan unless Warren has hidden it from me."

Q – Business schools

Warren: "I went to three business schools and at each found a teacher or two that I got a lot out of. I think that the priesthood of 30-40 years ago for efficient market theory strayed far from the reality of investing. We'd rather have a person who is bright but had chapter 8 of Intelligent Investor in his bones, we would take that person. It's not complicated but is disciplined and does not require a high IQ. The fundamentals are important, and so is understanding accounting and talking to and thinking like a consumer, but being a good investor doesn't require advanced learning. I didn't want to go to college. Would I have done better or worse if I'd just quit and read books? If you run into a few great teachers, and they change way you think, you are lucky. Like Charlie is to me as a great teacher. You can find them in academia and ordinary life. The teacher gives you insights and makes better person, like Charlie."

Charlie: "Ben Graham was unconventional, and Warren found out you can make a lot of money by sitting on your ass. He knew the approach wouldn't work for all times and conditions, and we learned that. Ben outlived the game he played personally. Lots of luck finding those types of deals where you buy something for a third of working capital. Warren had to learn a different game. If you're going to live long time, what you formerly knew is never enough. It's like the metaphor I always use with the one-legged man in ass kicking contest."

Warren: "Can we please have suggestions for another metaphor sent to me? Graham was not scalable. Graham had $12 million he was working with and was tiny and not scalable. He didn't care, because he wasn't interested in making a lot of money for himself. The utility of chapter 8 looking at stocks as business and chapter 20 about the margin of safety are of enormous value and not complicated."

Charlie: "Teachers teach the wrong things, like my old eye doctor who does obsolete operations. He said, 'but it's such a wonderful operation to teach.' They get these formulas in academia and create these fine teaching experiences. What a real feeling of worthwhile activity! It's all balderdash."

Warren: "Whenever you hear something described as 'elegant,' watch out."

Q – Investing abroad

Warren: "American investors are missing China. It's a long way away, it's different, it's complicated, it looks too hard sitting in Omaha to outsmart the Chinese market, and we have to get billions into things to move any kind of needle. It's tougher in markets we are unfamiliar in working in. In much of Europe we have to report when we own less than 3%, and that's tough when we get followers which are undeserved. We have problems by nature of size. It'd be a lot easier if we were a smaller fund. In Petrochina we could get large position, because the Chinese government owned 90% of it, and we only bought 1.4%"

Charlie: "Warren did so poorly the first time in China – he put in $200,000 got $2 billion out, which was not encouraging enough."

Q – Tech investing

Warren: "Tech or not, we base our decisions on the durability of competitive advantage and if we think we are better at assessing the probability of improving the durability. Amazon doing what it did I thought would be something close to miracle, and I tend not to bet when I think something takes a miracle. I would've been far better if I had insights. Bill [Gates] told me early on to switch from Altavista to Google, but I wondered who would then skip past Google. We saw at Geico that we were paying Google a lot of money for services costing Google nothing. We made a mistake. We went into Apple, because of the intelligence of the capital deployed and the value of the ecosystem. It didn't require me taking apart the iPhone and figuring out the components to see what Apple had. It was more the nature of consumer behavior. We miss a lot of things we don't understand well enough. But there's no penalty for not swinging at something as long as you swing at something. Stay in your circle of competence where you might have an edge because of experience or reason."

Charlie: "If one of us is stupid in some area, so is the other. It's a wonderful system. We're not ideally located to be high tech wizards. How many people our age have quickly mastered high tech? I've been to the Google headquarters. It looks like a kindergarten, a very rich kindergarten. All of the Google characters came and talked to us when going public. The mystery was 'what competition that would come along?' Would it be four or five players slugging it out or one dominant player? The airlines are better now than they used to be, but it used to be suicide. Competitive factors are extraordinary with four or five carriers at 85% capacity versus eight carriers at 70% capacity. Amazon was a miracle doing Amazon Web Services and changing the world of retail at the same time and without much capital and at that speed. We underestimated Jeff. We had a very high opinion and still underestimated him."

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Charlie: "Some of our age and stupidity is ameliorated by Ted and Todd. We are lucky to have them, as a lot of the ignorance of the older generation needs removal."

Edited excerpts from Adam Blum's notes from Berkshire Hathway AGM 2018.

Ist June' 2018

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About TrustLine

At TrustLine, we run a specialized PMS fund (Portfolio Management) for exclusive set of high net-worth clients (long only value based fund). We are a company with a single mission- to deliver superior long-term returns to our clients. We are managing over Rs.350+ crores of AUM for over 375+ highly satisfied clients. This makes us among the top 20 discretionary portfolio managers in India, with industry leading performance.

Over the years we, at TrustLine, have gained rich domain expertise by focusing and specializing in Portfolio Management Services (PMS). Unlike our competition, we are a unique firm focused only on PMS. This sets us apart and gives us a competitive advantage in the PMS space. At TrustLine we believe, the quality of "Research" is fundamental to delivering out-sized returns. When research is complemented by contrarian investment approach, the rewards can be dis-proportional. This forms the foundation of our investment choices and stock selection in our core PMS business. Our disciplined practice of this "Value Investment" principle has enabled us to deliver superior risk adjusted returns with significant out-performance over bench-mark indices.

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