2023 Berkshire Hathaway Annual Meeting Recap

May 18th 2023

The Woodstock of capitalism was on full display Saturday May 6th in Omaha! The energy flowing through the CHI Health Center was unparalleled with previous years with a capacity crowd of 40,000 owners in attendance. As usual, 92-year-old Warren Buffett, and his elder partner, Vice Chair, Charlie Munger (99) answered questions from shareholders for about six hours. I attended the event with my nine-year-old son, Sam. It was his first Berkshire meeting, and I coaxed him into attending by promising unlimited See's peanut brittle and a couple Coke Zeroes – now he's a Berkshire disciple!

Berkshire is one of the largest businesses in the world with a market value of over $700 billion and 383,000 employees amongst its many subsidiaries. Many large businesses today (especially publicly-traded) operate with an extremely short-term view. Management teams fear popular opinion on a myriad of divisive topics and bend and bow to every request, regardless of how extreme. Berkshire operates with decades-long time horizon and has time tested principles. These core convictions have guided Berkshire for over 50 years and drive Berkshire's culture. This long-term, consistent, rationale mindset is Berkshire's biggest advantage. As most businesses in the S&P 500 are trying to "find their identity," Berkshire chugs along the tracks of long-term value creation for its owners. How refreshing!

This meeting was one of the best in years, in my opinion. Maybe I'm just excited about the additional $6 billion in annual income stemming from Berkshire's $130 billion cash pile, but that's not all. Berkshire has its mojo back. After feeling out of step for years, its approach is in favor again. Its insurance businesses are firing on all cylinders; its cash pile again is valuable from an interest and potential opportunity standpoint (no more helicopter money, at least for a while!); and it's exercising some pricing power in railroad and energy businesses. Buffett actually gave forward looking guidance (kind of) by saying he believes operating earnings will grow this year. That doesn't sound like a stretch in corporate America but coming from Warren, you can almost take it to the bank.

<u>I have categorized some of the Q&A below, in sections I felt might be worthy of your time:</u>

<u>Succession:</u> Buffett has been asked about succession every year since at least 1991. Finally, during the 2021 annual meeting Charlie accidently slipped and let the world know Greg Abel is the CEO heir apparent (title now vice-chair of non-insurance operations). Berkshire also designated Ajit Jain as vice-chair of Insurance Operations. Greg, 60, sat on stage alongside Ajit, 71, during the morning Q&A session. While Greg will be CEO upon Warren's death/retirement, Ajit will oversee insurance. Ted Weschler and Todd Combs will oversee the $300 billion+ investment portfolio and Howard Buffett (Warren's oldest son) will serve as nonexecutive chairman of the board.

Berkshire has the most in-depth, telegraphed continuity plan of any business. The question most people are really asking when they ask about continuity is, "Will Berkshire be the same after Warren dies?" Will the culture, the mindset/philosophy, the profits, survive Warren's demise? My thoughts: yes and no. No one can fully replace Warren. Greg will not have people hanging on every word and seeking life advice. His leash will be shorter given he doesn't have an 80-year investment track record and the title of *Oracle of Omaha*. On the other hand, Greg is a better operator/CEO than Warren. Warren has mentioned this several times – indicating Greg's understanding and oversight of the operating businesses is superior to his. Greg won't be reading 10-K's looking for stocks to purchase (Ted and Todd will take this role). The culture will continue. It's deeply woven in the decentralized nature of Berkshire and it'll be Greg's job (and the board/Howard) to protect and continue it. The portfolio is already set. While there will be adjustments and opportunities, Greg will not have to reinvent the wheel; he can just steer the ship.

I believe Berkshire can thrive post-Warren. In some cases, it'll be better (more focus on operational excellence, better managed) and in some cases worse (losing the best capital allocator of all-time and Warren's voting power). Net-net, we don't see the retirement/death of Warren to automatically trigger the sale of our position.

<u>Float:</u> many long-term Berkshire owners are familiar with the term float. Float is capital derived from the nature of the P&C (property & casualty) business model. Insurers write policies and collect premiums today while paying claims later. As the insurance business grows, it produces more premiums and, in some cases, the claims may not occur for several years. Berkshire collects the float (it's a liability on its balance sheet) and funds its assets. If you're thinking, "Gee, that sounds similar to banking, where a bank takes deposits and funds its balance sheet" you're thinking about it the right way. With a few key differences notes below.

- Unlike deposits, the float cannot be withdrawn. Berkshire estimates no more than 3% of float could be called in any given year (annual report). Since 2000, float has grown from less than $28 billion to $164 billion in 2022 (annual report). Berkshire expects continued (albeit a slower pace) growth in float!
- Unlike deposits, where banks pay depositors interest, float can be free, and in most years for Berkshire, better than free. If an insurance company underwrites profitably (premiums greater than losses/claims) it results in an underwriting profit. For 18 of the last 20 years, Berkshire has underwritten profitably (2017 & 2022 were losers). <u>Total underwriting profit over this period was $29.2 billion. Meaning, Berkshire was paid $29.2 billion over the last 20 years to accept float (deposits), which grew about $130 billion, AND received the benefits from investing its float in common equities, wholly-owned businesses, and other assets!</u>

Float is one of the secret sauces to the Berkshire model. There are others (culture, capital allocation, time horizon, decentralization, etc.) but the float impact cannot be overestimated. In fact, Warren and Charlie bought a bank in early 1970s but had to divest because of new banking regulations. They quipped this year that without the new regulation it's possible Berkshire could've focused on banking instead of insurance (and they were both thankful they found the insurance path).

CATs (Catastrophe Reinsurance): with the float conversation above, considering long-term liabilities and the volatile world we live in, a few questions were asked about CATs. Berkshire has a reinsurance business that insures insurance companies liabilities when their financial strength is inadequate. For example, Berkshire can add to its exposure of hurricane risk in Florida (which it did for 2023) by accepting a greater loss potential in the event of a big event, in exchange for profits in the event a large event doesn't materialize. This sounds risky, but it's important to understand Berkshire always limits its risk of loss ($15 billion for the Florida example above) and re-writes the policies every year with new information and pricing. As more CATs occur each year, the prices insurance companies must pay reinsurance companies to protect against risks increase. Ultimately, as you're aware, the prices are borne by the policyholders. Ajit believes Berkshire reinsurance could earn $5 billion in 2023 in the absence of a large CAT event in Florida.

How does a world with more catastrophes impact Berkshire? We believe more CATs will and does equate to better/harder pricing, resulting in better profitability for Berkshire. See Warren's comments from 2019 Annual Report below:

Mistakes in assessing insurance risks can be huge and can take many years – even decades – to surface and ripen. (Think asbestos.) A major catastrophe that will dwarf hurricanes Katrina and Ian will occur – perhaps tomorrow, perhaps many decades from now. "The Big One" may come from a traditional source, such as wind or earthquake, or it may be a total surprise involving, say, a cyber-attack having disastrous consequences beyond anything insurers now contemplate. When such a mega-catastrophe strikes, Berkshire will get its share of the losses and they will be big – very big. Unlike many other insurers, however, handling the loss will not come close to straining our resources, and we will be eager to add to our business the next day.

Value Investing: every year someone asks a question about the durability of the Berkshire tried and true investment philosophy, value investing. Depending on the year and performance, the question could be something like, "Isn't your investment style out of fashion and unlikely to work in the future?" Warren and Charlie have previously stated, "All investing is value investing since the investor believe he/she is investing in something that will be worth more in the future." Value investing is simply paying less for an asset than its intrinsic value. This year Warren added value investing's durability stems from "other people doing dumb things." The world moves forward, products and services evolve, and the technologies change but Warren's advantage simply stems from his patience, long-term view, and willingness to take advantage of opportunities when other investors (short-term) are scared.

You might ask, given the intelligence of market participants, AI, algorithmic trading, and disruptive, new business models, how can a 92-year-old executing traditional, value-based investment philosophy still expect to select outstanding investments? Good question! The average holding period for U.S. stocks is five months, the lowest on record (source: NYSE)! If we consider a long-term investor someone with a five-plus year time horizon, I would guess this population makes up less than 3% of investors today. Essentially, my guess is 97% of investors are simply renters, while a mere 3% actually invest with an ownership mindset. Berkshire is investing in businesses, not renting stocks – giving it a huge advantage over short-term renters. Apple is a great example: many investors owned Apple before Berkshire. Some with outstanding, early calls on the business model and potential. But no one has profited like Berkshire (over $100 billion in Apple profits and counting). In fact, to my knowledge, Berkshire may currently hold the record for most profits (in $$) ever on a single stock – Apple! They weren't early, but Warren is playing the long game while many investors capture a 50% or 100% return and move on, he's willing to hold forever.

Debt Ceiling: Warren quickly shot down any concerns about the debt ceiling by saying "he could not imagine Washington allowing the U.S. to default on its debt by refusing to raise the country's debt ceiling, and risk disrupting the world's financial system by letting the world go into turmoil." The debt ceiling has been raised over 70 times in history.

Banking Crisis: Warren unequivocally stated "Future, unknown events will determine the future for bank shareholders." Berkshire has recently sold off many financial stockholdings after Buffett's concerns around balance sheets and interest rates. Buffett again reiterated he would bet anyone $1 million no depositor will lose money in a bank failure. He lambasted regulators, politicians, and the media for poor management, communication, and reporting of the current crisis. He believes clear, simple policy could be instituted to protect depositors from banking concerns, but also believes bank executives must be held accountable for poor management and oversight.

Geico: Ajit and Warren took questions on Geico's underperformance and lost market share to Progressive and State Farm. Ajit mentioned they have much work to do from a technology standpoint to catch Progressive but have made improvements and expect to breakeven (underwriting profit) in 2023 and get back to a combined ratio of 96% in 2024 (4% margin). Auto insurance is a thin-margin business.

Simplicity: most people/investors overlook the real Buffett genius – his simplicity. He has distilled difficult topics into simple strategies. His approach is so simple, most people are unable or unwilling to recognize it. They believe there must be a secret formula, that if only they could copy, they too could become a billionaire. The reason most people cannot follow Buffett's sage advice is because it takes time. If you're in a hurry to get rich, the Buffett way just won't do. Buffett's entire life is about deferred gratification, long-term thinking, patience, discipline, and treating people well. He's a contrarian, which by definition means, most people will not be able to accept his rules and principles for life and business. How many people do you know that have exercised the deferred gratification muscle as intentionally as Warren and Charlie? I know of none. The Berkshire model is incredibly unique and valuable and we continue to enjoy our partnership. Berkshire continues to be our largest holding and we believe its shares offer a 25% upside to our conservatively estimated intrinsic value.

Sincerely Yours,

John