RUANE, CUNNIFF & GOLDFARB INVESTOR DAY 2014

ST. REGIS HOTEL, NEW YORK CITY

MAY 16, 2014

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Average Annual Total Returns as of June 30, 2014	Year to Date	1 Year	5 Years*	10 Years*
Sequoia Fund	0.92%	18.42%	19.13%	8.67%
S&P 500	7.14%	24.61%	18.83%	7.78%

* Average Annual Total Return

The performance data shown represents past performance and assumes reinvestment of dividends. Past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Year-to-date performance as of the most recent month end can be obtained by calling DST Systems, Inc. at (800) 686-6884.

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As reflected in the current prospectus, the Fund's Annual Fund Operating Expenses for 2013 were 1.02%. Ruane, Cunniff & Goldfarb, the Fund's investment adviser, has agreed to reimburse a portion of the Fund's operating expenses. This reimbursement is a provision of Ruane, Cunniff & Goldfarb's investment advisory agreement with the Fund and will be in effect only so long as that investment advisory agreement is in effect.

Investing in the Fund involves risk. Investors should carefully review the risks associated with an investment in the Fund and understand those risks before investing. The principal risks of investing in the Fund include market risk, value investing risk, non-diversification risk, foreign (non-US) risk, currency risk, small-cap and mid-cap company risk, managed fund risk and liquidity risk. As of June 30, 2014, the top ten holdings of the Fund included:

Valeant Pharmaceuticals International, Inc.	17.7%
Berkshire Hathaway, Inc.	11.1%
TJX Companies, Inc.	6.8%
Fastenal Company	4.3%
Idexx Laboratories, Inc.	3.3%
O'Reilly Automotive, Inc.	3.1%
Precision Castparts Corp.	3.0%
Rolls Royce Group plc	2.8%
MasterCard, Inc.	2.7%
Google, Inc.	2.3%

Disclosures (continued)

Any sector focuses of the Fund are subject to change, and past returns are not indicative of future returns. The cash generation of a company in which the Fund invests may not continue given market or other conditions, and portfolio turnover may change depending on future circumstances.

Fund holdings and/or sector weighting are subject to change and should not be considered recommendations to buy or sell any securities. Current and future portfolio holdings are subject to risk.

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Remarks have been edited for clarity and relevance.

Bob Goldfarb:

Good morning and welcome to our investor day. We will take questions until 12:30. We have to vacate the room by one o'clock, but we will be around between 12:30 and 1:00 to answer any questions you might still have. Before we begin, I would like to introduce our team. On my right are Greg Alexander and Greg Steinmetz. On my left are David Poppe, who is the president of our firm, and Jon Brandt. The rest of our team is seated in the front of the room. In alphabetical order, they are Saatvik Agarwal, Girish Bhakoo, John Harris, Jake Hennemuth, Arman Kline, Trevor Magyar, Will Pan, Terence Paré, Rory Priday, Chase Sheridan, Michael Sloyer, Stephan van der Mersch, and Marc Wallach. I would also like to introduce Jon Gross who is our director of client services. In the front row are the directors of Sequoia Fund: Roger Lowenstein, Bill Neuhauser, Sharon Osberg, and Bob Swiggett. With that, we are ready for questions.

Question:

Thank you for doing such a great job, and thanks for once again closing the fund. As you so correctly noted at last year's meeting, Valeant has a hard time consummating deals with publicly held companies. Is its growth-by-acquisition business model flawed? Can it reinvest cash at 15% or 20% if it cannot do bigger public company deals at reasonable prices even with the aid of hedge fund managers? And since everything you said about Valeant at last year's meeting and in the annual report was so correct, would you hazard a guess as to whether the Allergan deal will eventually be consummated?

Bob Goldfarb:

We are not going to hazard a guess on the latter. We are not in the risk arbitrage business.

Rory Priday:

Right now Valeant is zero for two in the public arena in terms of trying to acquire companies when it is hostile. I think that Valeant is going to have a difficult time with Allergan. As Bob said, I do not think that we should make any projections about the outcome. But I do not think that Valeant needs to acquire big public companies to keep growing at decent rates. Mike Pearson, Valeant's CEO, said earlier this year that there were a lot of privately held companies that management is looking at. Our impression of the market is that there are not many of those companies that have revenues in excess of a billion dollars or so. Usually companies that big go public at some point. So Valeant will probably have a hard go of it at some time in the future. But at this stage, the company can probably still grow at a decent rate by acquiring private companies. But if Mike cannot find companies to acquire, he will probably do something else. Obviously with the Allergan deal, Valeant is being pretty creative at trying to find ways to consummate transactions. That is the one thing that stands out about Valeant — Mike sets very ambitious goals, and he gets criticized for that sometimes. But I do not think he sets them without having a path in mind to get there. I do not want to opine on whether it is right or wrong to set big audacious goals. But he has a path in mind and he has been pretty creative in the past. Inversions are in the news a lot today, but Mike did one four years ago with Biovail.

Mike and his team are creative enough to do things before other people think of doing them, and you see a lot of followers. So I think that he will try to be creative in growing the company even if he cannot consummate a big public deal.

Question:

What gives you such great confidence in Mike Pearson? Ackman puts him in a league with Tom Murphy and Dr. Henry Singleton. Sequoia once invested with Tom Murphy. Is Mike Pearson in a league with those people and the other great CEOs whom William Thorndike wrote about recently in *The Outsiders*?

Rory Priday:

I was not around when Sequoia invested with Tom Murphy. But I try to read everything I can about people like him. There are some good videos on YouTube with Tom Murphy. There is one three hours long in which Murphy talks about the evolution of his company. So you try to learn about people like Tom Murphy. My impression is the team at Valeant is as focused on creating shareholder value as the people that you mentioned. I have always felt that one of the challenges Mike Pearson faced was that legacy Valeant was both undermanaged and in some businesses that were not as good as the ones Tom Murphy was in. So Mike had to get rid of the weak businesses. The Biovail merger brought a number of products that were subject to genericization, but that was still a good deal because of the tax inversion. In the past, Valeant bought companies cheaply that had some products that were losing patent exclusivity. Subsequently, Mike has focused on acquiring better businesses with more durable products and less vulnerability to genericization. One of the trends you are seeing is that Valeant has been spending more money on companies that have better assets. You saw that with Bausch + Lomb and you are seeing that with Allergan. Allergan has some really good assets.

Bob Goldfarb:

It would be a huge mistake to underestimate Mike Pearson. Do not bet against him. He had a different vision of the pharmaceutical industry from that of anyone of whom I am aware. And he has executed that vision very successfully to date. You see a lot of fast followers. Greg, did anybody before him do an inversion in the pharmaceutical industry, do you know? David? He may have been the first one. It is very controversial right now, this practice of acquiring a company in a low tax domicile. But Mike made it clear from day one when he merged with Biovail that the main purpose of the deal was to secure the competitive advantage of having the lowest tax rate of any pharmaceutical company in the world.

You saw some of the smaller guys following him this year and Perrigo, which is one of our holdings, was one of them. Now you see Pfizer trying to buy AstraZeneca. So the big guys are starting to pay attention. I may have said this last year — he identified the sweet spots in the pharmaceutical industry both in terms of product category and in terms of geography. That is the reason why Allergan is his first choice to do a merger of equals because it is just a terrific fit with his existing businesses. He recognized that ophthalmology and dermatology are two of the best businesses in the pharma space. He is a leader in dermatology at this point. In ophthalmology, where is he right now, Rory, number three?

Rory Priday:

Number two. And, if you exclude some of the biologics, Valeant is probably number three in prescription pharmaceuticals after Alcon and Allergan.

Bob Goldfarb:

And if he is not successful with Allergan, as he disclosed at the initial meeting after the announcement of his proposal, he has a list of nine other companies, and he will go right down that list. It is not easy to do a hostile acquisition, particularly using stock as the principal currency. So it is very possible that he will not succeed with Allergan. But it is certainly worth trying when the businesses are so complementary, and Allergan has very significant costs that he can take out of the business, cost synergies primarily in the areas of research and development and SG&A. If you compare Valeant's R&D and SG&A ratios to revenues with those of Allergan, Valeant is just a much leaner company.

I know some of you were at the Berkshire annual meeting, and there was some discussion of 3G, the Brazilians who have been extremely successful. Anheuser-Busch InBev is their biggest success, but 3G has had others. I do not think that the Valeant playbook is that different from the 3G playbook. There may have been other pharmaceutical companies that cut costs and ran lean the way Valeant does, but I could not name one. Mike spent 23 years at McKinsey and wound up as the head of its global pharmaceutical practice. In those 23 years, he learned how you could maximize shareholder value in a pharmaceutical company, and that is what he has done so far. It is a little premature to include Mike among the outsiders because he has only been at Valeant for six years. If Mike continues to deliver exceptional performance in the future as he has to date at Valeant, he will certainly earn his place.

Question:

At last year's meeting, I asked you if Google was priced to perfection and you correctly said it was not. So I am curious; at this point what do you feel its growth prospects are? Could you also comment on the recent split, particularly with the non-voting shares?

Chase Sheridan:

I will comment on the split first; I think that is the easier question. For us it is a non-event. Sergey Brin, Larry Page, and Eric Schmidt already have voting control of the company; so it does not really affect our voting power in the company, which was zero to start with, effectively. Since we are very happy with the management of Google, it is not something we spend a lot of time on. Larry Page has shown himself to be a visionary and has done a better job with the company than we could have hoped.

As for the growth prospects of Google, it is a relevant question for any company that has a $360 billion market cap. It is always an issue. We asked ourselves that when we bought the company and it had an enterprise value of $118 billion. We thought with a company of that size, can you really invest in it if it does not have the potential to be the most valuable company in the world? Our conclusion was that it had that potential. We are not making any predictions. It is looking more and more likely over time, but we will see what happens.

I have no insight into the company's growth prospects beyond what is already out there and published. I look at what eMarketer puts out — growth in US desktop clicks and revenue is not very strong. So there are mature businesses within Google. But growth in mobile is still going like gangbusters, and Google has a greater share of mobile search than it has of desktop search. It is still penetrating some of the less-developed markets throughout the world. But eventually you have to wonder what the potential of the un-penetrated market, the remaining white space, is because Google's penetration is rather high.

There are so many projects that Google is investing in, some of which may bear fruit. But there are two areas that I think it has yet to monetize really well. One would be the video market. Through YouTube Google has access to some of the ad dollars that go into television spending, and it is hard to see where that is going at the present moment. But there is a huge, huge pool of advertising money out there for an aggressive and innovative company to tap, and Google is in as good a position as any to try to access that. Google still has a lot of work left to do to monetize local advertising through Google Maps or Google Now. The company is putting a lot of effort into doing that. So we will see. But relative to the growth that we can see, the valuation really is not terribly demanding.

Question:

Another company you own that has been involved in a merger is Omnicom, which is a smaller position. You have had differences with management in the past, and any disinterested observer looking at the whole merger process the company went through would have to say that at least at some point if not at all points, shareholder interests were not paramount. If you want to comment on that, that would be good. Also, I would like to know when you are looking at a good business with perhaps bad management, how do you make the decision whether to stay with a company like that or to cut the cord?

David Poppe:

The Omnicom-Publicis merger was interesting. We never really saw that there was a lot of synergy to get out of it. The companies would talk about some synergy in media buying because they both are very large ... the second and third largest advertising agency holding companies in the world. Omnicom announced last summer that it intended the merger to be of equals. I am sure most of you saw that the merger came apart in the last few weeks, and they are not going to be able to consummate it.

I never thought there was a ton of synergy to get. These are holding companies with literally dozens of agencies inside them. The agencies actually compete pretty vigorously against one another. There is not a lot of cooperation. There are a few back office efficiencies that you can get. There is some benefit in scale in producing TV commercials, utilizing TV studios, and in media buying. But we did not think there was a lot of synergy.

That did not mean we were opposed to the deal or that we thought it was shareholder unfriendly. My personal feeling — which nobody has confirmed, so take it how you want — is that Mr. Lévy at Publicis did not have a successor lined up and was looking for the best home for his business and thought Omnicom would be that best home. They struck a deal that looked like a merger of equals but Omnicom treated it as if it were a soft acquisition. Omnicom would control the management over time. The deal that they struck made John Wren, the Omnicom CEO, the CEO of the combined company after two and a half years. And while the number of directors on the board from each company would be the same, the directors from the Omnicom side had the right to pick the next two CEOs after Wren retired — which means, practically, you could have 25 years during which Omnicom would control the business.

My understanding is that there was an agreement up front that Omnicom would control the financial portion of the business as well, which makes sense because if John Wren were going to be the CEO, the financial function was not going to be in Paris; it was going to be in New York. When the deal came apart, that was one of the things that were cited. But I am not sure that was ever really an issue. I think Publicis struck a deal and then was not crazy about the deal that it struck. It was not really a merger of equals; it was a soft takeover. Because there was not a ton of synergy, I do not think that the market ever really responded very positively to it. Omnicom's stock ran up, but it only ran up with the market. It did not outperform. There was not a positive response that suggested that this was going to generate a lot of value. It was struck as a merger but I am not sure Omnicom ever treated it as a merger. There were also some regulatory issues. They structured the merger in a way to have the tax headquarters in the UK but the business headquarters in the Netherlands, and that ultimately was likely to draw regulatory scrutiny.

The good business, bad management — actually my feelings about Omnicom are somewhat complicated. But I think it is a good business with good management. Management has very tight financial controls. It runs three of the top five advertising agencies in the world. TBWA, BBDO and DDB are really good compared to the peer group. It is a self-interested management team that has compensated itself really, really well. You have to stand up sometimes and say, "How much is enough?" But that does not mean that management is not good at what it does.

Question:

Can you share your thoughts on IBM? It seems like there are doubts on the Street regarding the company's long term prospects. Sequoia seems to have a relatively small position. I am just wondering at this point what your view is and what your view of its valuation is.

Will Pan:

I will start with the valuation question first because that is a very important factor. The valuation is not demanding. It is ten times earnings, eleven times free cash flow. At that valuation, when the company is buying back 5% of its stock consistently a year, you do not need the business to do extremely well for it to work out for you as an investment.

In the long term, we keep track of the prospects for the company. We monitor those very closely. We think that management is making the right moves for the long term. The issue with IBM is that it has been so successful in the past. It completely dominated mainframes. It still does, but that is not a business that is growing very quickly, if at all. So IBM has this enormous anchor behind it. But at the same time, we see the company seizing on new opportunities like the move to the cloud. IBM has made a lot of progress on that front. The cloud enables IBM to deliver technology infrastructure as a service and so it can compete with Amazon for the small and medium-sized business IT market as well as for the smaller departments within large companies.

Over the last eighteen months, IBM has built a promising service platform by putting its middleware on top of IT infrastructure and delivering it in a way so that large companies, which are its major customers, can connect all the systems that they built in-house over the years with their new systems in what is called engagement. People are interacting with companies on mobile devices more and more, and companies are managing themselves through mobile devices more and more. So IBM can play a role in connecting the two. Even in what you might consider IBM's stodgier chips business the company announced a promising new initiative whereby Google, for example, actually says it is going to build its third generation data center, possibly, around one of IBM's chips. A year ago, two years ago, you would have never thought that a company like Google at the vanguard of what you would consider Internet technology and technology in general would go to IBM for one of its chips.

So it shows that IBM is on top of things technologically. Management is thinking properly long term about how to improve the prospects for the business. But you do have to remember that it is a large company and it has a significant base of business that is not going to grow very quickly over time. In the meantime, the valuation is undemanding and management is doing the right things with capital by buying back a lot of stock.

Question:

Last year you noted that Ritchie Brothers is in a large part levered to the US housing market, which I would probably broaden to include the construction market overall, and noted that it would probably muddle along until the market improves. I have a few questions surrounding the company. First, was this the original thesis when the shares were acquired in late 2008 to '09? And broadly, how do you think about or manage against thesis creep? Were you specifically looking for housing or construction exposure at the time? How did you end up with Ritchie as opposed to something like a Sherwin-Williams or a rental equipment company like RSC? Then lastly, from a portfolio construction standpoint, how long are you willing to hold small positions that have not been working, and how often do you reevaluate to see if there is a better opportunity someplace else for the capital?

David Poppe:

I think the answer that you are looking for is we are not very smart. We have owned Ritchie Brothers for about five years. Management built a business model that reminds me a little bit of the Fastenal business model. It is really simple; it is deceptively simple. But it is almost impossible for somebody to replicate.

Ritchie Brothers sells used construction equipment, a lot of CAT machinery in particular, Komatsu machinery through auctions. It is an unreserved auction, which means if you are a seller and you put it in the auction, you cannot take it out. Somebody bids a dollar; you sell that forklift for a dollar. It is really scary for a seller, but it is the only way, really, to run a legitimate auction where the buyers have confidence that they can potentially get a great deal and that the prices are in fact genuine. A lot of the auctions are run so that the sellers can pull their gear out if they do not get a price they like. For the buyer, it is a sucker's game. If you overpay, you can keep it — but if you get a good deal, you cannot. So Ritchie has a really good model. Again, no one has ever been able to replicate that. Caterpillar is trying with little success, so far. There was another company, IronPlanet that tried to do an online version. Some of you may know IronPlanet filed to do an IPO four years ago and that has never gone anywhere. So I think we got that right. Ritchie Brothers has a very good model.

The part that we missed is that Ritchie Brothers' heyday was during the US housing boom, and everybody was really busy, and contractors were getting tons of work. They needed to buy machinery, and machinery was very fluid. Ritchie Brothers has a good model. But there are ways competitors can fight back. CAT has fought back really hard, not wanting to lose that used machinery business and the parts and service that sometimes goes with that when you can keep the machinery in your system.

Ritchie Brothers had grown right through the recession in '01 – '02, but we were clearly surprised by the magnitude of the housing bust and the collapse of the construction market. I think also we probably missed — as did a lot of other people — that it is a stronger model in Canada, which is a more resources-based economy. So we got it wrong. It is a cyclical grower. That said, the market respects it. It trades at a high P/E even when it is not doing very well, because it is basically an impossible model for somebody to replicate. It ought to do well if and when the United States construction market ever becomes healthy.

It is small; it is a good quality group of people. I think it was not aggressively enough managed. Maybe management was a little overly self-satisfied coming into this downturn. But we will have a new CEO announced shortly and we will take a long look at that person and see if we want to continue. But the short version is we made a mistake. We certainly did not buy it in '08 thinking that it would be as modest a performer as it has been. Although I will say in our defense, when your losers are winners, you are still okay.

Question:

Could you comment a little bit on Fastenal? I am fascinated by the performance and the way you explained it in the annual report. Where does it stand today? At 4% of your assets with a 4% return in a market with a 32% return, it is interesting.

Chase Sheridan:

As you said, Fastenal's results in 2013 were disappointing. It grew something on the order of 6%. What happened there was that management pulled back its part-time labor in the stores in 2012 as demand slackened, hoping to protect the company's operating margin. Fastenal management is extremely cost-conscious. And I think management realized it pushed it a little too far. Historically, Fastenal's sales tend to track the sales labor force in the stores very closely. So when that number declined, it hurt sales. And the company realized that.

The remedy is very simple: Add energy to the sales force; the goal is 15% full-time equivalent labor growth for the store sales force. Historically, Fastenal outgrows its sales labor by a pretty good margin because the sales force becomes more productive over time. I call that "the hustle." So what you are seeing is a bit of an experiment. We see a correlation between Fastenal's sales and its sales labor. Now we are going to find out how causal it is. So far, the signs are good and in my opinion, it ought to work. We are seeing Fastenal's pace pick up, relative to its competition, in an environment that is not terribly favorable to the company. Non-residential construction really needs to pick up for Fastenal's top line to take off and give you the numbers that you are used to seeing out of that company. Fastenal is an absolute powerhouse in OEM fasteners but OEM fasteners are not growing much right now. So that is a bit of a drag.

There is no question that there are cyclical aspects to the company. But the secular growth of the company is more interesting. That will slow, undoubtedly, versus when we purchased the stock in 2001. Fastenal's valuation is always very high. The management gets a lot of credit from Wall Street, in part because the company returns any savings or cost benefits to the shareholder. Management is very shareholder friendly. Right now, the valuation is middling relative to the historical range. If the growth is slowing, you might say it is a bit on the high side. But keep an eye on the investment in sales force labor. What we are going to be looking for is a top line sales acceleration commensurate with that.

Bob Goldfarb:

One thing I would comment on in addition is that it still had a pretty strong performing year by any standards, other than those of Fastenal and companies of that ilk. But management took a real hit, if you look at the proxy statement, in its own compensation from levels that were not all that high for starters. I do not think I have seen any companies in that same situation where the top executives all took a really big hit. Chase, what were the numbers on compensation?

Chase Sheridan:

I am not sure what the hit was in the proxy. But I recall that the CEO's compensation was calculated to be 13% of the average CEO's for a company of his size. He did not regard that as an insult. Instead, he said, "That is because I deliver the best value." He was actually proud of that. To Bob's point, a few years ago there was a frivolous lawsuit against Fastenal, and the company settled for $10 million. Of course that hurt the shareholder, but what was interesting was that the company docked everybody's bonus. The company included that $10 million exceptional charge when calculating the bonuses of its people. Management really shares the pain.

Question:

I have another question about Valeant. Do you agree with Bill Ackman that GAAP earnings are immaterial in evaluating a company like Valeant?

Rory Priday:

Yes, I think for the most part, most of the things that Bill Ackman cited we agree with. If you are analyzing Valeant, you want to focus on what its adjusted net income is, what management is adding back to get that adjusted figure, and what it is adding back to adjusted cash flow. The big items for adjusted net income are restructuring charges and amortization expense. We do not mind adding back the restructuring charges because we view it as once the business that the company acquired is consolidated, in the next year the synergies are going to be there so that the business will be a lot more profitable than it was.

Usually the way Valeant talks about it, management adds those restructuring charges back as part of the purchase price. Those are the two main differences from GAAP net income. There are some other non-operating add-backs that the company makes. The one area I would focus on maybe is legal expenses and whether you want to add back one-time legal expenses. Some people would say that those are ongoing. Definitely legal expenses are part of an ongoing pharma business, but Valeant expenses its ongoing legal fees. It is the one-time legal charges that the company tends to add back. On the cash flow side, management also adds back restructuring charges. Those are basically all cash.

I know a lot of people complain about Valeant. They say that management is playing games with the acquisitions. Sometimes when companies take big restructuring charges or reserves, they release some later on so that they can make their income look good. Valeant does not do that. Most of the restructuring charge is paid out in cash. I do not think management is playing games in that area.

The one thing I would look at, and I do not think Ackman mentioned it, is that the cash net income and the adjusted cash flow from operations do not always line up because of increases in working capital. Valeant has not shown a tremendous amount of organic growth; so one thing to watch out for is how much of the difference between the adjusted net income and the adjusted cash flow from operations is going towards working capital. It has been significant in the past two years or so, but the company has been growing overseas in emerging markets where if the government is a customer, Valeant is not going to get paid for a long time. That is one reason why working capital can rise. There are other reasons, but for the most part, we agree with most of the add-backs.

Jon Brandt:

Valeant is far from the only company for which we would make adjustments to the GAAP net income. We spend a fair amount of time adjusting all of our holdings for amortization and a million other things. You could look at Berkshire as a great example of a company whose GAAP net income is not representative of the owner earnings. Valeant is not some special case. There are hundreds of companies where the GAAP net income is not the true representative of the earnings.

Rory Priday:

I would just add that if you look at the pharma industry — I have spent a lot of time looking at what other companies do — there are not any adjustments that Valeant makes that are materially different from what the rest of the industry does in terms of add-backs. In other words if you were to go through the line items that Valeant adds back, you would find virtually all of those added back to some degree at most of the companies. Companies have different policies, but for the most part they tend to add back what Valeant adds back.

Question:

Please comment on World Fuel.

Rory Priday:

I think we said last year that we were disappointed with how fast the company has grown organically. For those of you who do not know, World Fuel is a fuel reseller. It buys and simultaneously sells fuel in the aviation market and the marine market and the land market. It is an interesting company because most of the capital that it puts up is working capital; the company will simultaneously receive the fuel and pay the supplier. The company sells it quickly, but usually there is a difference of maybe ten days between paying for the fuel and receiving payment for it. That is the capital that the company puts in. But the company has done a good job with challenging markets. The marine market has been pretty tough; it has been soft. Management noted there has not been as much volatility in the price of bunker fuel, and that has hurt the company in that market because it sells derivatives to its clients or helps them use derivatives, and that is a service line for them. If the markets are not moving around a lot, then the company cannot sell those instruments because the clients do not need them.

But I would say management has done a good job. We really like the team. We are disappointed with the growth. My view is that in order for the earnings to grow, a lot of the impetus will probably come from future acquisitions. The company acquired Watson Petroleum, a land fuel business in the UK. World Fuel spent about $200 million. To the extent that it can allocate earnings to acquisitions like that — management is pretty disciplined — my guess, looking at the company's past acquisitions, is that it should earn a low double-digit return on its acquisitions. If you can spend all your earnings in one year on an acquisition and get a low double-digit return, then that should be okay. You have to weigh that against the lower organic growth or in some cases negative growth. But we like the management team and it is not an expensive stock.

Question:

You have such a small holding in Costco, and it is wonderful. The share price has doubled in the last few years. I wonder why you gave the girl the engagement ring but did not get married … add more stock.

David Poppe:

I think we get back to that answer of we are not very smart. We went out to see Costco in 1999 or 2000 and met with Jim Sinegal, the CEO. The stock was $27. It was probably 20 times earnings at the time — I do not remember what the earnings were back then. We came back and thought, "Wow, great company." I have to say I do not have a lot of heroes, but he is probably one of my favorite CEOs I have ever met. He is everything you have ever read about him. We had a toehold position in it. Fifteen years later, it is $111. We still own about a 0.1% position. So we just missed it; it happens. A lot of times they do not get into Sequoia so you do not know about them. But the only thing I would say there is you can look at a lot of pitches and take strikes, and not strike out in this game so long as you hit the ones you do swing at. Costco is one that, unfortunately, we just took a strike right down the middle.

Question:

On May 26, Valeant is supposed to have a meeting and probably increase the price of its offer for Allergan. And there is talk in the press about a price of up to $200 to buy Allergan. At what price would you say, "Oh my gosh, management has lost its head... Ackman pushed Valeant up to too high a price."

Bob Goldfarb:

Ackman is not going to push Valeant to pay more than makes sense. Management is very disciplined. Ackman is not going to dictate the terms of the offer.

Question:

What price is too high?

Rory Priday:

It is not a difficult analysis to figure out what they are offering for Allergan. In the past, one of the reasons we really liked Valeant was that it was acquiring companies for say five to six times operating profit. That implies a 15% to 20% pretax return. Then usually the company was borrowing 30% to 40% of the purchase price. You can get pretty heady returns because of the leverage and the minimal tax rate. With Allergan, it really depends on how you value the shares that Valeant is giving up in the deal. But the way that I look at it is that the company is paying, call it $45 billion. Post-synergies, Allergan is probably going to earn something close to $5 billion; so that is nine times operating profit. If Valeant goes up a lot higher than that, obviously, it could be ten times operating profit, it could be eleven times operating profit. My guess is that Valeant is not going to go a lot higher into the double digits just because it is already getting close to two times what it would normally pay for something. Some people may criticize the fact that Valeant is paying up for Allergan, but I would point out that Allergan has some of the best assets in the space such as Botox. People may cite other drugs, but Botox is cash-pay; the physician dispenses it. It has a brand on the cosmetics side. Women go in and they ask for Botox. There are a lot of reasons why it is a wonderful product. And you can pay up for that. If the company were paying something like fifteen times operating profit, $75 billion, then maybe we would look at it and scratch our heads.

Bob Goldfarb:

Rory, did you think that Allergan's forecast of its own earnings growth that it issued this past Monday was credible?

Rory Priday:

My personal view is that maybe the company was a bit aggressive on the top line. You saw AstraZeneca do the same thing with Pfizer. You do not want to get bought; so you have to put out a pretty rosy forecast. In Astra's case, the company is forecasting it is going to double revenues. It is already a pretty big company, and Astra is going to do it in ten years. The forecast period is a really long period of time. Who knows what the company is going to be generating in revenue in ten years? It is in Allergan's interest to put out pretty rosy projections.

That said, the company has great assets, and the top line, even if it does not grow 10%, could grow in the mid-to-high single digits. Certainly, if the company does not spend a lot more incremental money on SG&A or R&D, that is going to leverage and it should be able to get pretty high earnings growth. If it is not 20%, then maybe it will be in the high teens, potentially. It can do that with leverage as long as it gets the top line growth. The one thing we worry about, because we looked at Allergan before, is that it does have some drugs that could potentially face genericization. Restasis was one that we were particularly worried about. That is its biggest eye drug. The company staved that off. It may be able to have that drug for two or three more years without those worries.

The thing to think about here is if Valeant merges with Allergan, the Allergan shareholders are going to be getting $11 to $12 of earnings per share. If they were to use what they are getting in cash to buy the new Valeant, they could probably — even if Valeant traded up to $160 — they would still be getting enough stock that they would get 1.1 shares of Valeant. The new company could earn $12 to $13 next year — it might earn $14 next year. Allergan's shareholders have to compare what the new company would earn to Allergan's new forecast, which has shareholders earning $6.70 next year. It is $6.70 versus $14.

The way that I think about it is you have a choice of savings accounts and you could invest $5 in an account that is growing at 10% or 15% a year, or invest $10 in an account that is growing at a slower rate. I would prefer the $10 account, and that is the way I think about the deal. Allergan on its own will probably be growing faster, but while the combined companies may be growing a little bit slower, you might be getting almost twice the money early on. At least that is the way that I think about it. Allergan shareholders could make a lot of money, if they take the deal, because they would be getting twice as much in earnings power, probably within a year, if they use the cash to buy the stock. Even if they did not use the cash that way, they would still be getting $12 or $13 potentially with the cash.

Question:

What percentage of the fund is in cash? Are you ever going to lower the 1% fee?

Bob Goldfarb:

Right now the fund is about 80% invested. Our asset base is about $8 billion and our cash is about $1.6 billion. We charge a flat 1% on both the separately managed portfolios and on Sequoia because they are treated the same. They get the same allocations; they buy the same stocks, et cetera. We have had that fee structure for decades and we hope to be able to continue to earn it.

Question:

Congratulations to Jonathan for being one of the questioning analysts at the Berkshire meeting. I was wondering what your major takeaways from the meeting were and how you view the security.

Jon Brandt:

When you have been following Berkshire as long as I have, and many of you have, and Warren has been running it for 49 years, I would say that the major purpose of the meeting is just to see how sharp his mind is. And it is as sharp as ever.

Bob Goldfarb:

Five hours of Q&A.

Jon Brandt:

His stamina is amazing. It is almost impossible for anything material to come out of the meeting. It is a little bit of a carnival. There were some better questions asked, I think because of the format changes. But I would struggle to come up with any significant takeaway. In terms of the responses to my questions, I thought it was interesting that he said that he is not going to 3G Berkshire, if I can use 3G as a verb. But I cannot say I was surprised by that answer. Bob, did you have any key takeaways?

Bob Goldfarb:

No, I would just say in the last year or so, both in the annual reports and at the meetings, he has been more optimistic. Do you have that sense?

Jon Brandt:

Yes, certainly last year with the 12% growth, I would not call it guidance, but saying that it was a possibility or there was a reasonable chance of getting there, that sounded more ebullient than I would have expected.

Bob Goldfarb:

He has always wondered about the barriers that size would present to him. And clearly, as Jon said, the compound has slowed down as it has gotten larger. But he feels pretty good that even at this level of assets and stock price that he can continue to compound at a pretty good rate. So that has been the message that he has conveyed both in the annual report and at the annual meetings.

Greg Alexander:

One of my favorite lines of all time came from the most recent Berkshire annual. Jon, you are going to have to correct me on this. But he said that he now owns eight and a half — you like the line too — he now owns eight and a half companies, half of Heinz being the half, out of the Fortune 500, so he still has 491 and a half to go. Then he said the most remarkable thing, which is that he has bought most of those without issuing a material number of shares or running up the debt.

Jon Brandt:

David, did you have any key takeaways?

David Poppe:

I thought he was a little less connected to some of the businesses than you would like to see, and it just shows the size of Berkshire. It is harder to keep your head around everything that you own, even as smart as he is. I thought there were a few businesses that he was just not as connected to as I might have expected.

Jon Brandt:

I would say that is a good point. I asked a question about Forest River and the company's competitive advantage versus Thor. He said he did not know much about Thor. I think maybe 20 years ago, he would have devoured the annual reports and tried to get intelligence on the competitors. But he just seems to be trusting in Pete Liegl to do a good job at Forest River, which would include keeping an eye on his competition. There just might be too much for him to follow and maybe his attention flags a little bit from things like that.

Bob Goldfarb:

What percentage of Berkshire's earnings is Forest River?

Jon Brandt:

It is not material. These things are not really material. He focuses on the important things. But I think back in the day, he would have tried to devour everything. But there just are not enough hours in the day.

Bob Goldfarb:

I think he counts on you for that!

Question:

This week's *Economist* has an editorial and articles following it urging Berkshire to break into pieces for the sake of efficiency. Could you comment on that?

Jon Brandt:

I think you will see some difference of opinion up here on the dais about what Berkshire should do in the next 20 years. Bob does not believe it should be split up and I do not think so either. But I think Bob would like to see it cleaned up a little bit. The companies cannot really be sold because of the promise he makes. But there are a lot of advantages Berkshire has from putting all the businesses together.

Just one example is MidAmerican. It has put a lot of money into wind and solar assets. These renewable investments generate massive tax credits. MidAmerican may now be big enough to absorb the tax benefits with its taxable income because it has grown so much, but certainly at the time of some of these transactions, the fact that it filed consolidated income tax returns with Berkshire allowed MidAmerican to do these deals. Other utilities would have a more difficult time benefiting from these tax credits because they do not have enough taxable income to make full use of the tax break.

MidAmerican has still more options for deploying capital. Right now MidAmerican can either acquire or not acquire based on whether other things are attractive. Warren can decide. MidAmerican might be bringing him one deal and Iscar might be bringing him another deal. There might be junk bonds that are down. There might be auction rate preferred bonds that are attractive. He can do whatever he wants with the cash flow. He can go in whatever direction he wants. If you are just a utility or you are just a railroad or you are just a metal cutting company, you do not have as many choices about what you can do with your capital. So that capital allocation eclecticism or the ability to go wherever you want — it is a go-anywhere fund — is an advantage. You see these hedge funds called go-anywhere funds where you can invest in stocks. Look at what Warren has done with derivatives. Which division would be doing the derivatives? Those have been very profitable. So that is one example of something that would be lost.

Another example is in insurance. I do not know that Berkshire Re could take the type of risks that it takes if it were just a standalone company. I am not sure it could have done the kind of super-cat deals it has. Berkshire can absorb a $3 billion to $5 billion loss on an earthquake or a hurricane because it has all these non-insurance businesses pushing out the cash flow and earnings so that it would still be profitable in a very bad year for insurance. There are a lot of other insurance companies that will not write that business because they just do not have the capital base. I just think it would be a terrible mistake to break up the company.

Bob Goldfarb:

He is enormously proud of what he has created, and he should be proud. He does not want to split it up; he does not want to divide up his creation. He wants to build on it successfully and he will.

Question:

Two follow-up questions on Berkshire. I was at the meeting, and I do not know if you want to comment on this, but there was a lot of discussion among the people who attended about succession, which was also part of the *Economist* story. Also, Warren discussed Burlington and how much capital is being used to fix up and improve the railroad. Any comment?

Jon Brandt:

As I think I have said before in this forum, it is impossible to replace Warren Buffett. He is a master capital allocator. But as the company gets bigger, the ability to add value — it just gets harder. Even the most ingenious of capital allocators hopes at best to do two percentage points to three percentage points better than the S&P over time. One of the most important things over the last few years that have happened is that he has hired two investment managers, Ted Weschler and Todd Combs. I do not know that they have been there long enough to judge their records meaningfully, but they seem to be doing extremely well. Both have outperformed every year since taking the job at Berkshire, Todd for the last three and Ted for the last two years. They seem like sensible people; they seem to fit in with the culture.

I have often thought to myself, why not make an investment person the next CEO? Warren seems more interested in dividing the duties between a CEO and a CIO. But unless and until Berkshire goes with paying out much or all of its earnings as a dividend, which could happen, the CIO's job is going to be more important, arguably, than the CEO's. If Ted and Todd are as talented as they seem to be, Berkshire shareholders can feel pretty comfortable that the capital, the cash flow that is generated, is going to be allocated in a reasonable and rational and assertive manner.

The railroad — I think there is more to what happened in the last few months than just the weather. But it certainly got some bad luck with the weather, and the company is going to spend the money it takes to fix it immediately. That is another example of what I think makes Berkshire different: The managers at Burlington are not going to be worried about meeting some kind of earnings estimate for the June quarter. They are going to fix what is needed. Warren said in the first quarter report that he thinks that the problems of the railroad with the customer service levels are going to be fixed by the end of the year. And it is an irreplaceable asset.

Look at Union Pacific ten years ago — the trains were not even moving. You would have said — why would anyone ever trust Union Pacific to deliver any containers ever again, or grain or coal. But really the customers have no choice. Union Pacific has fixed its problems, and Burlington, whose problems are much less severe than what Union Pacific went through ten years ago, is going to fix them too. I am confident of that.

Question:

About fifteen years ago, I asked Charlie Munger at a Wesco meeting what he thought of investing in natural resource stocks as a hedge against inflation. He said in very strong terms that he thought it was one of the dumber ideas he had ever heard. He proceeded to lecture about the advantages of investing in companies "awash with cash," are the words he used. Lots of free cash flow that does not have to be pumped back into plant and equipment at inflationary prices. At this past meeting, according to the *Morningstar* blog, he said, "It is a blessing to have capital intensive businesses like BNSF and Berkshire Hathaway Energy, which give us an opportunity to reinvest large sums of capital at attractive rates of return." Then he went on to indicate that future acquisitions are likely to be in capital intensive businesses. Why the complete change in investment philosophy?

Jon Brandt:

Size.

Question:

That is what I figured.

Jon Brandt:

He has to find a way to put the money to work, and he has to accept less of a return than he did in the past. Charlie would say something like it is too damn bad that we cannot invest like we did in the past. But you are just going to have to suffer through it.

I still think Berkshire can get to a double-digit growth in intrinsic value per year, even with these horrible capital intensive businesses. But ideally you want to be investing in a company that can grow and does not need to put the money to work in capital expenditures. Then you can buy more companies and you have a compound interest wealth-creating machine. Berkshire is going to be a wealth-creating machine that goes just a little slower in the future. Warren said about utilities — it is not a way to get rich, but it is a way to stay rich. I think that would be true of the railroad also.

If you look at the return on equity of the railroad — everyone talks about return on capital because that is how railroads are quasi regulated — but the return on equity at the railroad is quite adequate. That is partly due to the fact that the railroad's leverage ratio has increased somewhat since Berkshire bought it. Also, at the utility, MidAmerican is intelligently using an increased amount of leverage in its acquisitions resulting in satisfactory returns on equity employed. The railroad has paid dividends to Berkshire equal to reported net income since Warren acquired it. Railroads are capital intensive, but in part through some borrowings, in part through the benefits of accelerated depreciation or what they call bonus depreciation, the railroad has been quote/unquote "a capital intensive company" but even with all it spent on capital, I am pretty sure it has dividended out as much free cash flow as it reported in earnings. So it is not quite as bad as it sounds. There could be some reversal of that bonus depreciation, but I still think free cash flow should be a decent percentage of the reported earnings. Same thing with the utility.

Question:

I have a two-part question. First, from a public welfare perspective, do you think the government should consider policies such as issuing longer patents if more and more pharma companies pursue Valeant's model, stripping out R&D and focusing on cash flow? Then I was also hoping you could talk about Advance Auto. It looks like the General Parts acquisition was very accretive to free cash flow, given the low cost of the debt and synergies, and it is more of a commercial business now. I was also curious about your thoughts as to how O'Reilly has been able to outperform its peers so consistently.

David Poppe:

I think on lengthening the patents held by pharmaceutical companies, we do not have any great insights there.

Rory Priday:

We sold maybe 80% of our Advance position. We sold it into the announcement of the GPI acquisition. We really like the management team there. We really like Darren Jackson. It is a pleasure to meet with him. We have dinner with him at least once a year and we have a couple of meetings with him. He is always thinking outside the box. He likes to visit other companies to learn their business models and how he can improve Advance.

We think that business is a good business. You have a good management team and a good business. Generally speaking, our issue is with the execution. If you look at the numbers, the execution was not really there. Last year, O'Reilly's comp was 4.3% and Advance had a negative comp. Advance is doing better now but it really was not executing at the store level. Management brought in George Sherman; he has streamlined the structure so that there is not as much top-down management of the stores. The GMs at the stores used to have 50 to 60 reports that they had to file with their superiors and George Sherman came in and he cut 75% to 80% of those reports. He basically told the GMs and the field force, "You have to focus on three things: sales, profitability, and customer service." It really simplified everything. I think you are seeing progress in the results. Advance had a very slight positive comp in the fourth quarter. It just reported yesterday that the comp in the first quarter was 2.4% after having multiple quarters of negative or flat comp. Clearly, George is having an impact on the field force.

Management is doing a good job. But we felt for a long time that the team was not executing as well as some of its competitors. That is why we sold down our position. We thought there was a good opportunity to sell into the GPI deal. I would just say that, yes, the GPI deal should be very accretive to the company because of the fact that it levered up to make the acquisition using very low cost debt and will generate cost savings as well. But just after the initial accretion, the earnings might not grow as fast, necessarily, because of the execution. That was our concern.

O'Reilly has consistently performed — I think it is just the culture. The company has an extremely strong culture. The management is very competitive. It is also more car parts oriented than Advance is. O'Reilly also just knows how to expand into a new region. When O'Reilly puts new stores in, management goes after the best car parts guys in the area. Management tries to incentivize them to come work for O'Reilly. It is just very focused on doing whatever it takes to convince the commercial garages to work with O'Reilly. The company has a better position with the national accounts too just because of the history of the business. There has been a focus on the commercial side by O'Reilly for a long time. It has had this hybrid 50 – 50 commercial/retail model and that is one reason the company has done well. It also benefitted to some degree from the CSK acquisition. The stores O'Reilly acquired in that acquisition were not the greatest stores, but their performance has clearly benefitted from O'Reilly's expertise on the commercial side of the business.

Bob Goldfarb:

On your first question about the drug patents, the current patent lives were very sufficient in the heyday of big pharma companies when they were discovering a lot of very profitable drugs. Big pharma made tremendous returns on capital. The problem really has not been the patent lives. The problem has been the poor record of drug discovery by big pharma. There have been very significant drug discoveries but mostly by the biotech companies. So I do not think extending the patent lives would necessarily result in better R&D from big pharma.

Question:

Sequoia Fund acquired a position in Canadian Natural Resources some years ago. It is my impression that you have never added to it. What are your thoughts about that company? Are you interested in investing in other energy stocks?

David Poppe:

Canadian Natural is a very fine company. Very entrepreneurial, good assets. The thing I like the most about it is that it has a clear line of sight of production increases going out for decades. It has a huge resource in Alberta in the oil sands and it is a very efficient producer. Unlike an Exxon, which has a very difficult time replacing its production every year, Canadian Natural has 6% to 7% production increases going out as far as the eye can see. The oil sands is a very rich, long-lived resource; it is also a very expensive resource. So you own the high-cost producer. You are making an implicit bet that the price of oil will be above $80 a barrel or CNQ does not really work. So you own a big resource but you own a high cost resource. We bought a little bit, I want to say it was winter of ’08 or beginning of ’09 when prices were really crushed, and we thought the price was far below the replacement cost of the assets, even in a low resource price environment. But it quickly recovered and we did not feel like chasing it.

Bob Goldfarb:

I think also when we bought it, we perceived a real competitive advantage in that it had friendly oil that could be sold into the United States and shipped into the United States. But with the astounding growth in development and exploration of oil in the United States there is less of a need, and that edge diminishes.

Question:

What is the investment thesis on Novozymes?

Arman Kline:

Novozymes is actually a spinoff of Novo Nordisk, which is the world’s largest maker of insulin. Using similar technology, Novozymes has developed ways to produce industrial enzymes going into, for instance, the food we eat, enzymes that prevent bread from going bad during transport through the supply chain and on the shelf at the store. They go into the detergents we use in our dishwashers and washing machines, all sorts of goods. It has an incredible core business. I think we can safely say it dominates its end markets with greater than 70% share in most of the markets it plays in.

It is an expensive stock. The reason for the price is the value of the core business and some opportunities potentially in two segments. One is bio-agriculture. The company just signed a JV with Monsanto. Monsanto paid Novozymes $300 million for the rights to its R&D, as well as what is currently in its pipeline. There is a lot of interest in producing non-chemical-based products to help increase yields at farms. Then a second business which the company is well-positioned in is cellulosic ethanol. Widespread use of cellulosic ethanol in the US looks unlikely to happen any time soon, but there is a fair amount of interest in it in countries like Brazil, which already uses much more ethanol in its fuel.

So it is an excellent business; I would say it has one of the better management teams. It has a very, very strong position in its primary end market. And it has a couple of opportunities to grow the size of the business significantly, potentially. The CEO came out a couple of months ago and said the bio-ag opportunity alone could double the size of the business. And that is just one opportunity.

Question:

I was wondering if you could talk about Jacobs Engineering. It looks like it is a new position in the portfolio in the past year or so. What is the investment thesis there, and what has kept you from making it a bigger position in the portfolio?

Arman Kline:

We actually owned Jacobs maybe eight or nine years ago. We initiated a position, which we later closed out due to some concerns at the time from our research. We reinitiated it. It is an engineering and construction company. We have always known it was well-run. It has an unusual culture in the engineering and construction world. If you compare Jacobs’ results over the years to those of others, the incidence of, let us call them blowups, contracts that really go against you is really much lower, and the magnitude of those problems is also lower. Jacobs goes after smaller contracts. It has about 95% retention with its customer base. It runs a very relationship-based business.

What got us interested is tied to what is going on with natural gas here in the United States. That has created a renaissance in the chemical industry. Jacobs was getting more than its fair share of that.

But the projects were not moving forward into the construction and detailed design phase as fast, and that has led to the stock underperforming, even though the backlog is growing, because the earnings have not grown. So we found that to be an interesting opportunity and we took advantage of it at the time. And in terms of owning more, I will let David comment on that.

David Poppe:

We have a lot of price discipline, and we hope to have it be a bigger position. We bought it originally for Sequoia with hindsight at a very, very good price, did not chase it. As time has gone by, we see really good opportunities for the business and hopefully we will get a price to be able to take the position up in size. It is a very good business but price discipline takes you a long way in our business.

Question:

Are there Sequoia positions that stand to benefit from IT spending on Internet security, which is certainly a significant issue today?

Will Pan:

I do not know that we generally take a top-down view and try to benefit from some particular industry trend. But certainly security is one of the things that IBM is very much on top of. Clearly the threats are becoming more pervasive. A lot of companies that are IBM's customers stand to lose reputation if they experience a security breach, not to mention loss of IP. IBM is very much on top of finding new ways to help improve security for its customers. The company's new approach is to assume that there are bad things going on. You can no longer just build a firewall and try to keep everybody out. You have to assume that there are people doing bad things, whether it is in your company or coming from the outside into your company. IBM approaches it as a Big Data and analytics problem. IBM analyzes all of the activity that is going on inside and outside your company and tries to find the patterns that are indicative of misuse.

IBM's approach has a different slant on it from that of some other companies. It looks like it will be successful. The company has acquired several companies in that arena. One thing that we thought was positive is IBM has come to the point where it has been willing to acquire a company. That was not the case in the past. IBM used to feel that it needed to build everything in-house. But now management has developed some expertise in M&A, and it has brought in a fellow from an acquisition to run that division and he seems to be doing a good job. IBM is going to have to make more progress in that area, but that is certainly one way that we are benefitting from increased spending on IT security.

Bob Goldfarb:

I think earlier it was commented on that IBM is not a large position in Sequoia. And the business that Will is talking about is not a huge percentage of IBM's earnings. So if you want to make a bet on cyber security, I think you ought to look elsewhere. Do not count on us for that.

Question:

What do you think your potential is to invest more of Sequoia's cash in the near term?

Bob Goldfarb:

We have been very modest net sellers this year. There is not a lot on the front burner that would consume most of that cash.

Question:

Two related questions on Valeant. There has been a lot of focus on the income statement. Can you talk a little bit about the balance sheet and how it has evolved over time? Second, how do you think about portfolio construction and position sizing, given your level of comfort with the company's balance sheet?

Rory Priday:

With the balance sheet, obviously the debt has gone up quite tremendously. I do not know offhand but a year ago maybe it might have been around \$10 billion to \$11 billion. Today the net debt is around \$17 billion. One of the issues with companies that are doing a lot of acquisitions and doing them very rapidly is that they have to borrow money — or they can issue shares as well — but it requires a lot of capital. Usually when people look at debt, they say the leverage ratio is the net debt to EBITDA or the net debt to operating profit. Valeant is pretty high on that metric.

But I would say that it is a little misleading because Valeant pays taxes at such a low rate. It is generating quite a bit of free cash flow relative to the debt load. So this year, if you were to exclude some of the cash payments for the restructuring charges that it is going to have to pay, Valeant might generate cash flow approaching \$2.5 billion to \$3 billion. The debt is five to six times cash flow.

That is on the high end of what we would feel comfortable with. Historically if you look at Sequoia companies, they have not had a lot of debt. But that is just part of the model. At least in the short term, Valeant is looking to reduce its debt burden and one way it could do that is by merging with Allergan, which would reduce the leverage ratio. It depends on the terms because as it stands, management said it can reduce the ratio of debt to EBITDA to three times. But Valeant is going to be making a higher offer, it sounds like, in two weeks and that higher offer will probably result in a higher leverage ratio unless the company decides to issue more equity for the deal. But it is something that we definitely watch out for. Valeant is at the very high end of the range of where we would feel comfortable.

Bob Goldfarb:

Earlier, we were talking about *The Outsiders*. Over 40 years, we have owned a number of these companies, and we made the mistake of not having a big enough investment in them. When you find someone as unusual as Mike Pearson, you ought to recognize his uniqueness by having a very sizable position and by not selling that position too early as we did with three of the companies featured in the book, General Cinema, Ralston Purina, and Washington Post. As for the debt, we have mentioned before that the company is extremely tax efficient because of its tax domiciles. And the debt makes them even more tax efficient because the debt resides in the United States. The interest is deductible and creates tax losses in the United States so that Valeant has been able to transfer its IP to low tax venues. The company does incur a tax liability on that transfer, but the tax deduction of the interest on the debt and the resulting NOLs have enabled the company to transfer the IP or to license the IP without having to pay cash taxes.

Rory Priday:

Just one more thing. We would be more worried about the debt if Valeant were less diversified than it is. The largest individual product is probably 2% to 2.5% of sales. The largest segment, contact lenses, right now at $758 million, is right around 9% of the business. But that contact lens segment is split up among a bunch of different geographies as well. So there is not a lot of product concentration. And there would not be that much even if Valeant succeeds in merging with Allergan. Everybody thinks of Botox as a cosmetic product, but there are dozens of therapeutic indications that account for half of its sales. We would be more worried if Valeant did a big deal and all of a sudden 20% of the earnings came from one product or something of that order. In some respects, Mike is pretty aggressive. But in other respects, he has been fairly conservative. One of the things that he has been conservative about is trying to have a diversified business model or diversified business.

Question:

A few questions with regard to Rolls-Royce. To what extent has the company's competitive advantage changed over the years? You discussed making accounting adjustments when you analyze a company. What kind of accounting adjustments do you make to Rolls-Royce's earnings? How do you think about its valuation relative to what the company could be earning five years from now?

Arman Kline:

I am going to try to remember all those and I might come back to you on some. But in terms of the competitive position, in the core civil aero engines business, its competitive position is as good as it has ever been. Rolls is the sole source on the A350 airplane, a 1,600-plus engine platform. It has about 40% share on the 787. Those are the two planes that are going to drive the majority of volume in the wide body segment, which is the high value segment of that market. There is some talk in the trade about a re-engined A330neo, but neither Boeing nor Airbus is talking about any truly new airplanes. The 777X, which is a derivative of the 777 that is currently flying, has a new version of the GE90 on it, and that is going to be the only player in that market, arguably for at least a decade, maybe even two. There is potentially a 757 coming out but that is not really a wide body. That is a single aisle long-range plane. But Rolls' competitive position is excellent. The point that the company always makes is that it is going to deliver in the next five years the same number of engines it has delivered in the last two decades.

In terms of the accounting adjustments, it is probably the most complicated income statement of any company I have ever looked at. There was a little bit of excitement around that after the earnings announcement at the end of the year because the FRC in the UK, which is like the FASB here, had the company change the way it accounts for some of what is called risk and revenue sharing partnership income. The accounting change alters what Rolls reports as earnings, but the new requirement has no effect on the company's cash flows or the essential economics of its business model.

The core question that you need to ask yourself about Rolls is when the company sells an engine, and it stays in operation for 20 to 30 years, what is the return Rolls gets on that engine through its life? If it is a good return, then placing an engine should be considered a value-enhancing activity. There are different ways of treating the accounting because Rolls sells the engines for either zero profit or maybe even a loss on a big engine order. So you have essentially negative cash earnings initially and as the spares volume supports the engine over the years, you have positive. How do you account for that in terms of value? If you account for it just in terms of the cash losses, then in years when Rolls is delivering a lot of engines, it is going to report lower earnings, which might suggest that the business is worth less. That does not quite make sense to me because the engine sales are enhancing the value of the business.

Rolls sells an engine as a package with a service contract that is usually ten or fifteen years in duration. The airline pays a fee per hour of use for the length of the contract. To price the package, Rolls takes into account what it figures will be the total cost of the engine, spare parts, and service, and estimates a margin for the entire deal. As revenue from the airline comes in, Rolls books a margin on each dollar. The cash is going to be lower initially when Rolls is delivering all the engines, but higher than reported earnings in the out years when revenue is mostly coming from spares. And the beauty there is your spares business is regulated. If you fly your airplane for 100 hours and the part is perfectly good, it does not matter; you still have to change it regularly. Every 100 hours you go in and you do your inspection; you change XYZ in parts. Unraveling the economics of the business is complicated, but the company does give you an immense amount of detail. The earnings release runs 70 pages. So you have all the detail you need. You just have to make judgment calls on what you think you want to pay for the business. That is the civil side.

The marine side, the defense aerospace side and the energy side are different. They do not sell the OE equipment for a loss. The sales from these businesses do generate cash income up front. You make a margin up front and you make money on the spare parts down the line.

Then you had a third part, valuation. The valuation has come down since the FRC investigation came out. It has historically been mid-single-digit revenue, low double-digit earnings grower. Through time, again using the metrics the company uses, which is value versus cash, that is probably a reasonable estimation of the growth of the business going forward. It trades for a low teens multiple. That seems pretty reasonable. You can look at it as a company whose earnings, using the adjusted figures, are going to grow at those moderate rates for a long, long period of time given the very large backlog; or you can say it is going to earn less cash today but that cash earnings stream is going to grow fast. After these engine deliveries start to wind down, and the spares start to deliver the margin, you are going to start to get a lot of cash coming in.

Bob Goldfarb:

I would say on the competitive side that I think when we bought Rolls, Pratt & Whitney, which is owned by United Technologies, was pretty quiet. The company seemed to have lost interest in risking the kind of capital that you need to build a new engine. But Pratt subsequently came back with a geared turbofan engine. We would prefer a duopoly to a three-player market, but Pratt's reentry will not affect Rolls-Royce's earnings from its big engines for eons.

Arman Kline:

Right. Just to add to that, Pratt & Whitney today is in the narrow body segment where Rolls is essentially not a player. That segment is a duopoly with GE and Pratt. Pratt is not in the wide body, where it is a duopoly with Rolls and GE. As Bob said, it will be many, many years before we see all three players in the same markets.

Question:

You guys mentioned Ritchie Brothers earlier. I was wondering if you could go into why you think the business is so protected. You mentioned that you do not think anyone can come in and replicate it. What are the barriers to entry that you see?

David Poppe:

The business is protected on the auction side. I think it has been proven out over the last few years by companies that have tried to enter. As I mentioned before, Ritchie runs unreserved auctions. It takes a huge amount of trust to convince a person who owns a $500,000 bulldozer to drop that into an auction — and by the way, you have got no guarantee of what price you will get for it. You might have to sell it for $100,000. That person cannot pull the equipment out once he has signed a contract.

There are other auctioneers including some reasonably good-sized ones — none of them operates that way because they cannot get the sellers to cooperate. But if you get the seller to cooperate and he has trust that you are a good marketer, you will attract an audience. For the buyers it is much more attractive to come and feel like "I could actually buy this $500,000 piece of equipment for half of what it is worth." It does not happen but the perception that it could happen is really important. Everyone has to feel that it is a fair process. So the seller is taking risk in a Ritchie Brothers auction that most of them do not want to take. This is his business. That might be the most valuable asset the company owns or the seller owns. So that is important. Ritchie built a level of trust. It built it by performing at auction, by bringing big crowds to these auctions. I do not know if you have ever been to one, but it is sort of amazing how many people show up just to watch. Half of them are not even bidders or sellers; they are just there for the entertainment value.

IronPlanet runs on-line auctions and in that one respect it seems like it would be very efficient. You do not have to have physical sites. But in fact people, if they want to buy a $500,000 bulldozer, they kind of like to sit in it and make sure it is what it is. The physical site turns out to matter a lot. So on the auction side, it is very well protected. It is a very good model.

That said, several Caterpillar dealers run CAT Auction Services and there is still a big world out there of Komatsu dealers and independent brokers who may have different economic priorities. Caterpillar might decide that what it needs to do is have a very robust used equipment business so that it gets a bigger share of parts and service on those used machines. CAT dealers could overpay customers who want to trade in a bulldozer because they like to keep that equipment in-house. It is a very, very competitive marketplace. As I said, we think Ritchie has a good model, a protected model. It is not surprising that Caterpillar really dislikes Ritchie and really wishes it would go away, although it is not good when the giant in your industry hates you and you are much smaller than it is.

But there is a stronger cyclicality to the industry than we maybe thought there was when everything was booming and Ritchie looked like it was a secular grower. It has been an interesting period since '08 when you have had very low interest rates, so that people have been able to hold machinery at pretty low cost. Maybe as business picks up, that will change.

Question:

I have a couple of questions. The first one is about China. I was curious as to what your feelings were about China and if you were looking at some investment opportunities over there. The second is about Berkshire Hathaway. Do you think that Warren and Charlie are setting up Berkshire with these capital intensive businesses so that when they are no longer there, there will be opportunities to deploy cash with basically a guaranteed return?

Jon Brandt:

On the China part, I would say with every company we study, we look at all the end markets, and if a business is in China we might expect that business to grow more than others. But as Will was saying before about cyber security, we are not really top down. We do not say, "Let's find something in China and do it." We do have somebody who is fluent in Mandarin and who is over there quite a bit. So he might want to comment on that a little bit. And if there were a business that had a huge exposure to China and it was growing fast, we would be excited about that if the company were domiciled in a place where we were sure the shares were actually ours and the people running it were trustworthy.

To answer your question on Berkshire, it is true that if you get reasonable returns in the utility and in the railroad, that makes the job of capital allocation somewhat less critical because it reduces the amount of cash flow that is discretionary and that the CEO and the CIO will have to deploy going forward. There is a lot to be done in utilities. The nation needs more transmission lines; it needs more environmentally friendly power generation, et cetera. And the railroad is a good place to put money for the country because railroads are very fuel efficient. I would not say the returns are guaranteed because regulators have to be reasonable. Warren is making a bet that the regulators will be reasonable because the country does need that investment. But Berkshire is far from being an idiot-proof company.

Stephan van der Mersch:

Just to echo Jonny's point, as somebody who tries to find investments in China, there are many reasons — a lot of good reasons — to not try to invest in China. The standards for corporate governance to get into the Sequoia Fund are really, really high. And I cannot think of many examples of companies in China, Chinese companies, that get anywhere near that. You can invest in companies with great corporate governance in the US that invest in China and you can get the Western quality corporate governance. It is a really tough place to do business.

I am not a macroeconomist, but I have been going to China for about ten years now. The economy there looks like at least half the growth is based on building new buildings. I would be on a bus tour visiting a company and we would be in a rural area, 20 to 30 miles from a city, and you would see a 60-story skyscraper coming out of a farm field. It is easy to look through the press and see this kind of thing all over the place. All this is financed with bank loans. You look at the project and you just do not see how the interest is being paid. I wonder what happens when the loans cannot get paid. I used to think that the political system would be pretty resilient in the event of an economic downturn and now I am a lot more skeptical of that. That said, there are certain places where it is very interesting to keep on looking. The challenge always is finding people you can trust.

Question:

Talk about an idiot-proof company, MasterCard — do you have any comments on its current growth projection and also the valuation?

John Harris:

I never thought about this until you just called it idiot-proof, and I do not know what it means about me that I am the guy who covers it. What can I say? It is a good business. It has given pretty much the same guidance, financial guidance, for a long time now. The guidance is very attractive. It implies earnings per share growth in the high teens or maybe even approaching 20%. I think it is very realistic. So it is a high growth business. The market appreciates it as such.

When we first bought it, there was a bunch of clouds swirling around it and it did not trade at the multiple it trades for now. In retrospect we paid maybe thirteen times the earnings the first year out of the gate after the IPO. Now it probably trades for more like 22 or 23 times earnings. Different people can have different points of view on the reasonableness of that or the attractiveness of that. But certainly it is a high growth business. It is deserving of a high valuation. I would say that the couple of big issues that have always been in focus for us in terms of business risk at MasterCard — with each passing year, the news just seems to keep getting better. The breaks just really go MasterCard's way.

There was actually news that there were regulators in the EU who would like to see the interchange system banned entirely, which if there had been a news item to that effect five years ago, I shudder to think what the stock would have done. But people have learned over time that the company is so amazingly resilient to these regulatory challenges and challenges to the business model that the stock just completely shrugged that news item off, which tells you something. So I think we feel okay about it. Whether it is an attractive valuation or not, you have to make your own determination.

Question:

Both Rolls and Precision Castparts are in the aerospace supply chain. I am curious how you think about the two. Which is a better business and which is a better long term investment?

Greg Steinmetz:

Which is better? We hope for greatness from both. Arman, you argue Rolls, I will argue PCP. Rolls and Precision are in the same industry, which is a fantastic one, commercial aerospace, because of an eight-year backlog we have now on jets. But unlike Rolls, which is making multi-billion-dollar bets when it sells an engine and has to wait for the cash, Precision gets hard money up front when it sells a part.

Precision Castparts, I really like the management there. Mark Donegan is first rate. He thinks about every penny and Mark is great at identifying adjacencies and interesting companies in those adjacencies to acquire. He has a great track record of taking these acquisitions and really milking them for all they are worth.

Why I think Precision can keep growing is that it generates — this year it will be close to $2 billion of cash, which management has shown it has been able to invest at a 15% return. The question is, can Precision keep finding acquisitions. The big one they did a couple years ago, Timet, a $3 billion acquisition — you could spot that one coming from a mile away, or in our case, 3,000 miles away, thank you very much. Precision closed on a $625 million one just last March, but I do not know what is out there now that has the kind of scale that Timet had.

Management says there are some and the team is always looking, but I would say my biggest concern is whether Precision can keep finding these acquisitions. Once Precision gets them, I have no question that its managers can make them great. What Precision has done with Timet and most everything else it has bought since we have owned it gives me a lot of confidence. So my concern with Precision is just whether management can find the deals. If Precision does not, we still get organic growth because the 787 is going to go from seven or eight builds a month last year to ten this year, and maybe even higher. We have got these new narrow bodies coming on, and they are increasing the build rates of those. Because Precision is so good at improving efficiency, it has a better cost position than its competitors, and the company is able to pass that on to customers and win market share.

Arman Kline:

I would just add — they are in the same industry, but they are leveraged to two different parts of it. Over the long run, PCP has more leverage to the new build. Because of the unusually large number of engines that Rolls will deliver in the next few years, it is tied pretty tightly to the new build market for now, but once those engines are placed in service, Roll's earnings should hold up better if and when demand for new planes slackens. Rolls's service contracts run for ten to fifteen years. But the other thing with Rolls is that it is now buying Tognum, which puts the company more in energy systems, making it more diversified. It is not so civil-dominated a business anymore. And it is in marine whereas PCP is more levered to aerospace.

David Poppe:

I would just interject one thing. I agree with everything Greg said. But Mark Donegan is not milking the assets; he is sweating the assets. He is really good and he is driving these businesses harder than people thought they could be driven. Not to overuse the comparison, but I think these 3G guys running Budweiser would really appreciate Mark. He is a very good CEO.

Question:

I think last year you commented on QinetiQ, the UK company run by Leo Quinn. Since we are talking about the management Hall of Fame today and different individuals, I am curious — when you made the investment a couple years ago, given that it was primarily in the defense industry and the growth opportunities at the time were challenging to say the least — how has the company performed, and what do you think the future looks like in light of the industry it is in. And how Leo is doing?

Arman Kline:

I do not think anyone here would argue with your premise. Yes, defense looked challenging, and I think it turned out to be even more challenging than Leo or we expected. That said, he has done just a wonderful job with that business. He sold off the US assets, admittedly for less than all of us would have hoped. But he has turned the UK asset into a grower with a double-digit margin. He is generating very good returns on assets. And he has got some technologies in that pipeline.

QinetiQ was named after the character Q in James Bond, the story goes, because it was supposedly the division that created special gear for the UK military. It continues to have some unique new technologies. The company has a couple that Leo has talked about publicly. OptaSense is one that uses fiber to map out all kinds of things. You install the fiber along oil pipelines to see if anyone ever taps into it. It is being used now in down-hole fracking. It is used to monitor international borders. It has the potential to be a very large business and it is non-defense. The company is also getting into using systems to monitor power line and power grid usage with another unusual technology. So I think that Leo has done the right thing. As he would say, he has put all the chips on the table. The roulette wheel is spinning, and we are going to see what happens with those technologies. And he has cleaned up the core asset very well.

Question:

Thank you for your work. I do miss seeing Bill and Rick up there. I wonder if you could talk about the compensation system. I do not think that has been covered before — how you keep the veterans interested and how you keep the new guys incentivized.

David Poppe:

Everybody except me is massively overpaid.

Bob Goldfarb:

Very good. That's it.

David Poppe:

We have a great team. We do not spend a lot of time benchmarking against other firms. We treat the analyst track as a career. I think a lot of other firms do not do that. We want someone to be a world class stock analyst and want to do that for the rest of his career. For people who do a good job, we pay really well. So that is part of it. Without getting into dollars, there is a psychology there. Some of the really good firms that I know and good people that I know, their analysts are all very young and it is up or out. We would like to have people be world class stock analysts and do that job for a long time and know their businesses better than anybody.

We are lucky that we have them. This is an incredibly strong team and hopefully that comes through to all of you. If you are a certain kind of investor and you want to be a value investor and own long term positions and work at a place that has a concentrated portfolio of best ideas, this is a pretty good home. We have a lot of people who do make it a career. We have really low turnover. And we empower — there are some younger people over here, Rory, Will, Saatvik, you have seen today, and Stephan — pretty young people who are really empowered in our system. They have real responsibility. They are not doing spreadsheets and supporting Jonny and Greg; they are doing the work. So that counts for something too.

We are fortunate we have got some really smart people with a lot of options. But they get more responsibility maybe with us than they would have somewhere else. That all comes together. Pay is part of it. Responsibility is part of it. Being on a winning team is fun for everybody. And I do not want him to get a big head, but Bob is a pretty good boss. He empowers people and he takes your input very seriously. So it really hopefully — they will all shake their heads, it feels like a team. You feel like you are on a winning team and you are making a contribution that is highly valued by the CEO.

Question:

In the Berkshire annual, Warren mentioned how after his passing, he is going to have his money go into Treasuries and into the S&P 500. Does that in any way worry you? Why not keep it in Berkshire as opposed to diversifying into the S&P?

Jon Brandt:

I think he was just talking about a trust for his wife. I think he said that the money that is going into foundations is going to stay in Berkshire. Clearly the comment raised a lot of eyebrows. I was asked to stick to questions about the noninsurance businesses, but I kept getting e-mails from people, ‘‘What’s this about the S&P 500? Is Berkshire not going to outperform it?’’ I think he was just looking for a simple solution for his wife, and I would not read too much into it.

Bob Goldfarb:

It is very interesting that someone who for many years preached the gospel of the inefficiency of the stock market wants to invest in an index fund. Clearly, he thinks that the world has changed since he and his friends in Graham and Doddsville were running modest amounts of money and trouncing the index to a world where a lot more very intelligent people running large sums of money are trying to beat the market.

Question:

Can I ask you to comment on the remarkable success of TJX? Do you think this is countercyclical or is it secular? Does the web represent an oncoming freight train?

David Poppe:

That is a really good question because the performance has been so strong since 2008. So it does make you wonder if it is a countercyclical business. At the same time, the performance was pretty darn good for the seven years prior to 2008, with one or two hiccups. So it is hard ... I think TJ was definitely helped by the fact that the consumer needed to focus harder on value. But as the economy has gotten stronger, it has not lost any traffic, has not lost any sales. And TJ, interestingly, has improved the mix subtly over the last three or four years. There is more high-end product in the store, which suggests there is a wealthier shopper in the store, too. So this is not strictly a Walmart-type story of a middle-class customer who is desperate for or hungry for value. It is appealing to a broad cross-section of shoppers, which I cannot say we knew would happen.

At the same time when you talk about being countercyclical, since 2006 Carol Meyrowitz has been CEO, and she has just been hugely additive in everything that she has done. I think she is a fantastic leader for that organization, a very charismatic and inspiring leader. She is a great buyer. I knew that before. I can tell you going back years — I do all sorts of fun things like go to apparel trade shows — and you meet these people who deal in the product; they loved Carol. This is long before she became CEO. She is widely regarded as one of the four or five best apparel buyers in the country. So the perfect person is leading an organization that is mostly about buying and driving good deals. I think that is a great combination. There is a little bit of a countercyclical aspect to it, but there is also a little bit of an aspect of great merchandising and great leadership at the top.

You also say, well, it is countercyclical ... gosh, TJ has done awfully well in the UK. It is doing really well in Germany. The company's Canadian division, Winners, already had the highest margins in the company when Carol took over, and the chain is pretty much built out. So there is not a lot of room for improvement. But the company is expanding Marshalls into Canada to complement Winners. The home goods business has been a home run. All parts of the company are functioning at a really high level. So I would say the economy helped TJ; it did not hurt the company as it did many retailers. But leadership also makes a big difference, and probably more of a difference. And I think that TJ is just a business that is run by the perfect person to run the company. That helps too.

We would be more concerned I think ... Carol is 60, and I am hoping she decides to work to 70 instead of 65 because she will be tough to replace. It is a good company, and even there, Carol has invested so much in training; the management team below her is stronger than it was by far ten years ago. This is one that we have known for fourteen years, so we really have some history with it. But the management team is the strongest ... or as strong as it has ever been.

At this point, the internet is a greater threat than it is an opportunity. Whenever competitors can enter a business easily, it is not good for the incumbent. And we are keeping an eye on these flash-sale websites. But the treasure hunt aspect will be difficult to replicate on the web. Much of the appeal of the physical store is finding that one dress or jacket that is available in one or two colors or in one or two sizes. TJ itself did re-launch its website last year, but management is developing it slowly and is being careful to make the merchandise offering and customer experience different from that of the physical store. In addition, in 2012 TJX acquired Sierra Trading Post. It had three outlet stores at the time, but was mainly a web-based business specializing in outdoor sports apparel and footwear. TJ is planning to open a few more stores to see how well that format works off the web.

Bob Goldfarb:

The interesting thing is that Ross Stores, which we visited at the same time we bought TJX, we did not buy. But Ross has done every bit as well. The Nordstrom Rack is a lot smaller than TJX, but it seems to have some traction and quite ambitious expansion plans.

David Poppe:

Yes, it is a pretty good industry, and I would say the structure of the industry is also ... it is not an easy business, because you have seen a lot of other smaller people fall out. But the two dominant ones have only gotten stronger. The incremental cost to produce your next piece of apparel is very low; so people tend to want to overproduce. As long as you have a good outlet for that production, it does not hurt you so much. Ross and TJ make really good homes for excess product. They allow the manufacturers to produce more than they might otherwise.

Question:

You once opened Sequoia and then closed it. At what point would you ever open it again?

Bob Goldfarb:

We reached a new peak level of assets and we want to make sure that we can manage at that level of assets as well as we have managed at lower levels of assets in the past. We do not want our universe to be more restricted. We want to be able to buy companies with market caps of $3 billion, $4 billion, $5 billion, and have them be meaningful to our performance. We would give that up if we had a significant infusion of funds. So we are going to stay closed, and we think that is best. All the constituencies seem to like it. Our investors hopefully will benefit from the flexibility that that gives us. Our analysts are always coming to us with ideas that have market caps of $3 billion to $4 billion to $5 billion, and so I think they would not like us to say, "Gee, we have grown assets to a point where ... it is a great idea, but we have grown assets ... it really does not make sense to pursue that idea."

Question:

I was just wondering if any of you can talk about what is going on in the Ukraine and whether any of the holdings in the fund have any exposure or opportunities involving Russia?

Bob Goldfarb:

The Ukraine itself is just too small to make any difference whatsoever. If you are asking about Russia, a couple of our companies do have participation there. Mohawk is one, where they bought an Italian company.

Terence Paré:

Mohawk bought Marazzi, and it has a very successful business in Russia. One of the interesting things about the Russian flooring market is that after the Soviet Union collapsed, property was transferred to the citizens, and the houses that they lived in, because they previously did not own them, were in a terrible state of disrepair. The most recent statistics out of the government, and I am not sure how reliable these are, but something like 66% of the residences in Russia need very serious remodeling — which would include flooring, obviously. But the business, while significant for Marazzi, is not terribly significant within the whole of Mohawk. When I spoke to the people at Mohawk about the situation in the Ukraine, their Russian salesmen were actually pretty happy because they could now do business in the Crimea.

The other thing to remember about the flooring business is that it is not a strategic industry for Russia. It is not an oil company or a natural gas pipeline or something like that. Marazzi has been in Russia for over ten years. It is run by Russians. They are scattered all over the country. They are basically small business people. You never know what could happen in Russia, obviously. But Mohawk is not terribly concerned about any ill consequences, and I think management is being reasonable about it.

Question:

Back to Berkshire. It originally did the repurchase at 1.1 times book, and now he is gone to 1.2, do you have any comments on that?

Jon Brandt:

I think he was being too cheap when he said 1.1. He realized he was not going to get any and 1.2 is still enough below intrinsic value that it is accretive enough for shareholders. I think he was too wide-eyed when it traded there just for a little bit. I do not think he loves buying back stock, but he is starting to realize that it is good to have yet another way to build value. I think Berkshire is going to do it more if the stock trades there. I think he is reconciled to it.

Question:

What is book value?

Jon Brandt:

Book is almost $140,000, so $168,000 would be the buy price. It is interesting, it was a little below $140,000 at the end of March but the Graham Holdings deal was not closed as of March 31. When that deal closes, the deferred taxes associated with that position go away. So on a pro forma basis that would help just a little bit. I do not know if that would have gotten book to $140,000 at March 31st, but most likely it is above that level today.

Question:

You said something about buyback right now, and I have heard a lot of praise of leadership of a number of companies through the day. Can you speak specifically with respect to IBM and its leadership, and whether you have the confidence in the leadership that it will go through with the fair amount of changes that are taking place in information technology? IBM had been through that struggle in 1990s. Does it have the bench strength, and is it doing the right things?

Will Pan:

One thing that is interesting is if you read Lou Gerstner's book, and if you observe IBM through the years, it has been pretty well aware of technological shifts and has predicted many things. I have talked to people recently who tell me IBM had done the pioneering work in 3D printing, for instance, and it sold those patents to what became Stratasys when IBM realized that that business would be very slow to take off over time. IBM did pioneering work also in speech recognition. So it has been on top of a lot of the technological trends over time. It has done a fairly good job also of mapping and trying to understand what the opportunity set is on a commercial basis — how big the business could be and when the business could take off. It is fairly sophisticated in that, and its research department is great.

What was lacking and what we focus on now is whether IBM is properly grabbing hold of the things that it observes and invents. I think since Gerstner really came in and reenergized that company, it has done a much better job of recapturing the pieces that were not proprietary. It used to be very much a mainframe-focused company and now management has realized that it has to participate in open innovation. You saw IBM's support of Linux, you see its support of OpenStack, and you even see IBM opening up its chips for its open power initiative, which is how IBM got Google to be interested in the technology. So we have a fair amount of confidence that out of the technology industry, IBM has a good grasp of what is coming in technology and that it could move faster. But IBM is moving pretty quickly in terms of getting ahead of some of these new changes that are coming down the pike.

Question:

In the annual report you say that the total return for the Sequoia Fund was 34.6% in 2013. What is it so far in 2014, and what are your goals for the balance of the year?

Bob Goldfarb:

We never set goals for the year. We would often be far off in either direction.

David Poppe:

I think we are basically flat for year-to-date as of last night. I do not have it in front of me, but we are flat for year-to-date, and the market is up maybe 2%. So we are about two points below the S&P 500 Index year-to-date.

Question:

Just going back to Valeant, you mentioned it is at the higher end of some of your implicit thresholds of leverage. I am curious what would cause you to sell or resize that position?

Bob Goldfarb:

If it became overpriced.

Question:

Would you please comment on the Graham Holdings, your insight into Warren's deal, and what you think of it?

Jon Brandt:

I looked at it briefly. It looked like a good deal for Berkshire in that Berkshire got to offload a position that I do not think Warren was excited about going forward and that had a large built-in capital gain. Plus Berkshire did not have to pay tax on the gain because of this bizarre cash-rich split-off tax regulation, which does have some logic behind it. The ability to include cash is a weird little wrinkle. The cash is the boot, as they call it. If you are trading two assets and they are of slightly different values, you can add some cash to make it equal. The Washington Post company — it is now called Graham Holdings — also avoided taxes because it disposed of its Berkshire shares, which Berkshire got to effectively buy back at what might seem like a valuation of more than 1.2 times. But whenever you are trading assets, you just have to look at what you are trading. So I would not say that he violated the 1.2 multiple for a buyback with that. Berkshire got a TV station which it may or may not have been really interested in, but which was necessary to make the pieces of the exchange equal in value. They both avoided taxes. I believe Berkshire got more value than Graham Holdings did because Berkshire had almost a zero cost-basis on its Post shares, whereas the Post had a much higher cost basis on its Berkshire shares. But it probably works out pretty well for both companies.

Question:

I was at the Wesco meeting where Charlie talked about not wanting to buy asset-intensive businesses. As I heard it, he was talking about the customers of a Ritchie Brothers, capital intensive, highly cyclical low-value businesses. My two cents is there is absolutely no change in investment philosophy. The capital intensive entity that he is setting up at Berkshire is in regulated businesses with visible, attractive returns. With regard to Berkshire in the future, I do not worry about an idiot manager. But I do worry about an uninformed regulator. So how do you think about the regulatory risk?

Jon Brandt:

It is a risk, and I do not want to be flippant. But I will try to be brief here because we are running out of time. MidAmerican is in maybe eleven different jurisdictions. It has transmission in Canada, transmission in the UK, utilities in Iowa, Washington State, Utah, Idaho, Oregon, Colorado — the list goes on and on. In the United States you have one regulator per state. So at least there is some diffusion of risk in the utility business. Could they change the rules at any time? Sure.

Bob Goldfarb:

I would just say it is a trade-off. If you want a business that is absolutely essential and it is a monopoly or duopoly, you are probably going to have a regulator. So it is a trade-off. He wanted businesses that had essentiality and durability, and the price for those businesses is the risk of regulation.

Question:

I'm wondering if you comment a little more on Mohawk. Just general prospects and what your thoughts are.

Terence Paré:

It is interesting, a couple of these meetings ago Bob mentioned how important the jockey was in our evaluation of companies. When Bill Ruane and I first met with Jeff Lorberbaum, the CEO of Mohawk, in

Calhoun, Georgia — it must have been ten years ago — Jeff had a list of maybe six or seven companies that he thought were viable acquisition candidates. And they were all in the United States and they were all relatively small.

If we fast forward, we find out that Jeff kind of grew up with the business as he was building it. When he bought Unilin, which was after we had taken a position in the company, you began to sense the possibilities outside the US. That changed the calculus for the potential growth of the business. When we first took our position, we were thinking — at least I was thinking — of Mohawk mainly as a domestic business in the US, with limited growth potential tied very much to the US housing market. Now the biggest piece of the business still is tied to the US housing market and the remodeling market. But Jeff has found a way to deploy the capital that the business produces in very interesting ways.

Now, he has not batted a thousand, but as was mentioned before, he found potential with Marazzi and has a meaningful investment position in Russia, where the market is growing very fast and where he is making a lot of money. He has investments in Australia, a joint venture in Brazil. Jeff inherited a company that made just carpet, which he recognized was a slowly declining business. And so he has expanded into different modes of floor covering. Mohawk is still a very much a carpet company, but Jeff has also made it the largest ceramic tile manufacturer in the world, and ceramic tile accounts for more floor covering than any other kind. Mohawk is also a leader in laminate flooring and will soon be manufacturing luxury vinyl tile, a new and fast-growing floor covering. So rather than thinking of Mohawk as a US carpet business, we really have to think about it as a global floor covering company. Mohawk now stands very well to benefit from a resurgence in remodeling spending and residential and commercial construction here and all around the world. Jeff really has turned Mohawk into something that certainly I did not expect.

As for a recovery in the US, we are … somebody mentioned regulators before … hearing some noise that the requirements for home mortgages may get a little looser and more favorable for first-time home buyers. If we get a little more employment, that would be a positive in the US. So what used to be a US business where we were counting on share buybacks and growth with the US housing and remodeling, is fundamentally a different animal now. I think, looking ahead, it will do okay.

Bob Goldfarb:

In some ways, the question about Mohawk really goes back to what was asked before from the *Economist* article about whether Berkshire should be broken up. One of the disadvantages of a huge conglomerate like Berkshire is that Warren is not thinking all the time about flooring acquisitions in Italy or selling into the Russian market. Jeff Lorberbaum at Mohawk, all he is thinking about is flooring. I do not know who is running Shaw for Warren, and that person might be thinking about acquisitions. But he has got to run them by Warren. He has got to get Warren's approval. There is an advantage in focus that you have when you are only in one business and that Berkshire, with its 72 businesses, may lose. It is true that a number of those 72 businesses have done acquisitions, but it is easier for Mohawk to acquire companies than for Shaw. Jeff's acquisition of Unilin did not turn out to be that good a deal because of the subsequent decline in housing and the timing of the acquisition.

Question:

I know it is early in the season, but do you have any sense of what distributions might be like for this year?

David Poppe:

We expect to distribute about $2.50 per share in June. In addition, we will pay about $1.58 per share in November if there are no additional gains and losses on sales of securities through October 31st.

Bob Goldfarb:

On that we'll end the meeting. We thank you all for attending.