

Learning from Deals

Analyzing this year's largest deal involving two top tier teams – and applying key elements to BigSur's investment philosophies, strategy and ideas

On February 14th, it was announced that Heinz, the US food company (and also one of the most iconic US brands) is being purchased and taken private by Berkshire Hathaway (Warren Buffet's holding company) and 3G Capital (the Brazilian private equity firm). Each company will invest \$4 billion of equity and be equal partners. For another \$8 billion, Berkshire acquires redeemable preferred stock yielding 9%. The \$72.50 per share cash transaction includes \$12 billion of new and assumed debt, valuing Heinz at \$28 billion (a 20% premium above the closing price of the stock before the deal was announced).

This is the largest deal the food industry has ever seen, and the largest M&A transaction so far this year. Berkshire and 3G made the acquisition to take Heinz private to allow for greater flexibility in restructuring and building up the company's global platform. The focus is to build the Heinz brand globally and concentrate on the core businesses to create a bigger and better company. We like this deal on multiple levels- the management teams involved, the target company, the strategy behind the acquisition, and the financial vehicles used for execution.

There are many key takeaways from this deal that align with different aspects of BigSur's investment approach and current strategies and ideas. In this piece, we take the opportunity to bring client's attention to a high profile and relevant deal and use it as platform to highlight some of our own ways, including:

- Importance of identifying and following good management and investment teams
- Strategy behind the acquisition- companies with strong global brands and "keep it simple" approach
- Financial vehicles used for execution- preferred vehicles and the use long term financing
- Implications for our views- positive for equity markets, and validation of two holdings in our portfolios

The Thinking Man's Approach



February 2013 | Series #4
Ignacio Pakciarz | CEO

In this Thinking Man note, we discuss recent deal between Berkshire Hathaway and 3G Capital to acquire Heinz, the iconic US food company. There are several different aspects of the deal which relate to the investment philosophy, strategies and ideas we have at BigSur. We take this opportunity to inform clients about the biggest deal the food industry has even seen and explain how it ties into some of the things we are doing at BigSur- including looking at companies with strong global brands, applying a "keep it simple" investment approach, and using preferred vehicles and long-term financing to enhance yield.



Following Good Management Teams

While we keep tabs on M&A activity, this transaction has particular interest to us because of the players involved. One tenet of our investment philosophy is identifying and following good investment and management teams. Warren Buffet is an iconic investor, and we identify with his simple and value based approach. We also know how good the 3G team is, led by Jorge Paulo Lehman, going back to their days when they led Banco Garantia in Brazil. They later sold Garantia to Credit Suisse in 1998. In 2008, the 3G team used InBev, the international beer company they had built up from a Brazilian base, to engineer the \$52 billion Anheuser Busch merger. The partners were back in the news again in 2010 when their New York-based 3G investment fund took over Burger King, the third largest US hamburger chain, for \$3.3 billion. 3G Capital has a history of imposing cost-cutting and greater efficiency on the companies it operates.

We like to follow these types of highly talented and successful teams- understand what they are thinking, what strategies they are using, what companies they are targeting, and how they see the markets. It is a high quality input we consider when we are creating our BigSur views.

Strategy: Global Brands and Keeping It Simple

The strategy to target a company like Heinz coincides with one of our long standing investment themes- focusing on market leading companies with strong global brands. Our BigSur Equity Portfolio consists of stocks which exhibit these qualities- they are global, blue chip companies with a high percentage of revenue generation outside of the US. We have long held the view that these are the types of companies to target, and have had success utilizing this strategy.

Another aspect we like about this deal is Buffet's "keep it simple" investment philosophy, which he describes as, "I invest in a company if I understand its business and can predict the utility of its products that it manufactures or services that it offers in the future." He cites Heinz as a deal which fits into this philosophy- a company with "an easy-to-understand cash-generative business model." Heinz has good underlying products used around the world, and with the right strategy can be expanded to be a more global company with greater distribution of its products. This "keep it simple" philosophy is something which resonates with our firm- we also make it a point to invest in companies and investment vehicles that we fully understand, that are transparent and have a clear value proposition.

Financial Vehicles: Use of preferreds & long-term financing

To execute this deal, Buffet is looking to lock-in a long-term yield of 6% on the \$12 billion investment (\$4 billion in equity and \$8 billion in the perpetual preferred with 9% coupon), in the same way that he did in the transaction with Goldman Sachs perpetual preferred. In a world of zero interest rates, the 6% is pretty attractive and clearly Buffet does not expect rates to go up fast or soon. We at BigSur have been implementing a similar strategy investing in financial and industrial perpetual preferreds, with success for the past few years. It has been an important part of our investment strategy, so much so that we have even defined this perpetual and preferreds as a distinctive "asset type" in our clients statements, separated from traditional fixed income and equities.



3G Capital and Berkshire are locking-in long term financing with a total new debt assumed of over \$5 billion (from Wells Fargo and JP Morgan). Low borrowing costs make it a good time to be a buyer using leverage (especially when you buy businesses with consistent free cash flows from an established player like Heinz). We have been implementing a similar strategy in many of our real estate deals by taking leverage- looking to enhance the cash-on cash we will earn on a stable and core property with limited downside price risk. For a high quality asset with a solid income stream, we believe the use of leverage is an appropriate tool to help boost returns. There are even some clients, with the appropriate risk/return profile, who have taken advantage of the low cost of borrowing to take a limited amount of leverage on their financial portfolios.

Implications for BigSur Market View and Model Portfolios

There are clear parallels between aspects of the Heinz deal and our own investment philosophy, approach and current strategies. Another interesting implication is regarding our current market view- we are positive on equities and believe that there is still good value to be found in the stock market for long-term investors today. Warren Buffet is a value investor, and his willingness to pay 20% premium signifies optimism about the long term performance of quality stocks. The deal is also symbolic of increased M&A activity, which is a positive factor for equity markets- especially at a time when US companies have over \$2 trillion of cash waiting on the sidelines.

Berkshire Hathaway is a holding of the BigSur Model Portfolio, and a few of our clients who like exposure to individual equities also hold the stock. We also have exposure to the 3G team in our BigSur Model Portfolio, through the Burger King bond (9.875% coupon, maturing Oct-2018). We bought this high yield bond for some clients when it was issued at par, immediately after the hamburger chain was taken private by 3G Capital. We consider this deal validation of two of our model portfolio's investments- first, the market reacted very positively to the deal. It is also validation of our investment in Burger King- the 3G team was given a resounding vote of confidence by one of the most successful investors, Warren Buffet, who not only co-invested with 3G, but gave the team the mandate to oversee all the operational changes at Heinz.

Conclusion

There are many aspects of this Heinz deal which reinforce things we are doing at BigSur on many different levels- from a focus on global brands and a simple investment approach, to the use of perpetual & preferred vehicles and long-term financing to enhance yield. We like to keep a close eye on what the top tier talent is doing in the investment and management world, and use their actions as checks and high quality inputs for our own investment strategies and ideas.



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