
Kraft Heinz is a warning to not always invest like Warren Buffett



By **Jonathan Shapiro**

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Warren Buffett is without question the world's greatest living investor. He is also the role model and template for a generation of great fund managers that have followed his ways.

But for those who have blindly followed his stock picks, the weekend [he released his annual shareholder letter](#) was nothing short of a disaster.

One of Buffett's biggest positions, in packaged food giant Kraft Heinz, suffered a [spectacular 30 per cent share price decline](#) after it made a host of horror revelations. That included a dividend cut, a monster write-down and a regulatory investigation.



HJ Heinz was formed in 1869 and merged with Kraft Foods in 2015. Today it's the sauce of share market pain. **Bloomberg**

Kraft Heinz, along with other consumer staples stocks, has been under pressure for some time as cost-conscious consumers shift towards cheaper private label brands while health-conscious consumers favour more natural food products.

The giants of the consumer packaged sector have become targets of activist investors betting that some operational and financial engineering can restore value. Short sellers, meanwhile, have bet that their over-leveraged lumbering businesses have further to fall.

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But Kraft Heinz is particularly interesting because of its illustrious share register.

In 2013 Buffett's Berkshire Hathaway teamed up with Brazilian private equity fund 3G to buy HJ Heinz for \$US23 billion and two years later they spent \$US50 billion to merge with the listed Kraft Foods.

That the wholesome folks at Berkshire would form a pact with ruthless cost cutters at 3G also attracted controversy and some curly questions, which Berkshire's Charlie Munger batted away.

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"I don't think we have ever had a policy that loves over-staffing," Munger said in 2013.

But critics [also questioned the business sense of slashing costs](#).

As early as 2015, fund managers doubted whether these declining brands really could prosper if their advertising and research and development budgets were being slashed.

The aggressive use of debt financing raised further doubts that the "3G way" would work as effectively in packaged food as it previously did with beer.

So last week's disaster announcement vindicated the view that valuable brands can be impaired by aggressive cost cutting and a failure to respond to changing habits.

As US analyst Josh Brown said on social media: "You can do all the M&A and cost cutting you want, the middle of the supermarket is a carb and salt cemetery."

The Kraft Heinz crash is also a blow, albeit a manageable one, for Hamish Douglass' Magellan.

The fund had amassed an enormous position in the packaged food giant and is the largest "active" manager in the company with 33 million shares.

That holding lost about \$600 million in value in Australian dollar terms on Friday, equating to about 1.1 per cent of Magellan's \$54 billion of global equities under management reported in January.

In [March 2018](#), [Douglass](#) said the investment in Kraft Heinz gave them access to the best private equity operators in the world [3G] at no cost.

However, Magellan was not oblivious to the structural challenges as consumers opted for cheaper private label products or more natural organic foods. But it still backed 3G.

"Even considering these risks, though, the 3G-led drive to improve profitability and its expansion ambitions make Kraft Heinz an attractive risk-reward proposition for investors."

Even 3G's Jorge Lehmann expressed concern that [he had become a "terrified dinosaur"](#) as habits shifted.

Still, it seems the investment world had failed to fully appreciate how big the challenge had become.

One hedge fund said it considered shorting Kraft Heinz when the stock traded three times higher because it had "lots of debt, no growth and the only way to go for margins was down".

But it shied away because of the "Buffett and 3G halo".

Sydney hedge fund Montaka, however, has been actively and openly betting against big food. At the Sohn Hearts & Minds conference last November, the fund's portfolio manager Chris Demasi [pitched Campbell Soup as a short](#).

Kraft Heinz was another short bet, a position its investors often queried.

"It's defensive. It pays a good dividend. It's a household name. Warren Buffett owns it," Montaka wrote in a note to clients last year.

"We've heard the same sound bites, and they too readily overweight the importance of the past, relative to the importance of the future."

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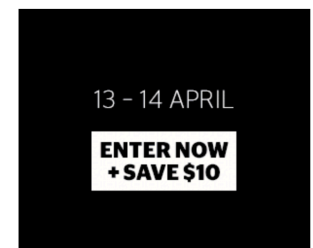
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