Montaka's Andrew Macken, the short seller taking on Buffett's 'inevitables'

By Vesna Poljak

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The Australian fund manager successfully shorting Kraft Heinz and Campbell Soup believes changing consumer tastes and unrealistic market expectations have created a golden opportunity to bet against a wider group of stocks that are a throwback to a bygone era.

That refers to a time when shoppers were less discerning, and competition was not as fierce. But evidence that Millennials have lost faith in the brands that assert themselves as authorities, along with changing nutritional preferences, the acceleration of competition from international retail and the emphasis on growing private-label ranges poses a delicate challenge for which mega-brands appear unprepared.

Kraft Heinz, which counts Warren Buffett's Berkshire Hathaway as an investor, unleashed a $US15.4 billion ($21.7 billion) impairment last week against the value of some of its world-famous brands. Its quarterly earnings missed analyst expectations and it disclosed a US Securities and Exchange Commission inquiry.

Montaka's Andrew Macken: "The same themes relevant in sugared cereals are in canned soup and peanut butter." **Peter Rae**

Andrew Macken, the chief investment officer of Montaka Global Investments, said when folksy market wisdom deviates from reality, it can be a "dangerous thing" for investors.

For decades, such stocks have realised reliable returns but that was undermined by Kraft Heinz's bombshell, which sent the stock down 27 per cent in a single session on Friday.

"In this case what has been a truth for 20 years is now a myth. Not all investors have updated their thinking," Mr Macken said.

Montaka is short Kraft Heinz and Campbell Soup, but also General Mills, Kellogg, Kimberly-Clark and Edgewell, the maker of Schick razors.

Mr Macken's colleague, Chris Demasi, presented the fund manager's Campbell Soup short at the 2018 Sohn Hearts and Minds conference, arguing the stock was on too high a multiple for inflated earnings, and investors had used it as a yield substitute. Meanwhile, fresh food and nutritional awareness were leading consumers to smaller brands and the kind of investment needed to reinvigorate top-line growth would be unpalatable to Campbell.

Short thesis

Those themes are just as relevant in sugared cereals as they are in canned soup or peanut butter, according to Montaka.

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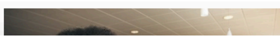

The idea for the short thesis originated in 2016 with the penetration of private-label consumer packaged goods, but expanded quickly as the portfolio managers realised this was not the extent of the risks to the outlook.

"[Private label] makes life really difficult for the traditional premium consumer brands, Campbell's Soup, Kellogg's, Kraft Heinz, General Mills," Mr Macken said. "The more we get into it, the more we realise these guys are copping it from all angles. It's not just private label against which there's a 30 per cent price difference, but consumer preferences are changing too."

That goes beyond ingredients and freshness to trust, as Millennials are more likely to put faith in peer reviews over marketing.

Further, investors have not fully come around to the idea that valuations for these titans do not, as Mr Macken suggests, reflect a future of slimmer margins, slowing revenue growth and reduced market share. Instead, investors are positioned for growing the top line and expanding margins. And why wouldn't they? As Mr Buffett wrote in 1996: "Companies such as Coca-Cola and Gillette might well be labelled 'The Inevitables'."

Increasing revenue is difficult because of the 20 per cent to 30 per cent price premium to challenger products, and growing margin is just as hard because the businesses are all trying to solve the margin problem with the same strategy.

"Profit margins had been expected to increase by many in the market because of these major cost reductions that all these companies have pursued without fail," Mr Macken said. "That logic suffers from the fallacy of composition, 'that only works if I do it and nobody else does it'."

In reality, margins have not increased for the past 18 months despite slashing expenses. And more often than not, savings need to be reinvested to protect revenue.

"You can have revenue growth, you can have cost savings, but you certainly can't have both," Mr Macken concluded.