

Slim pickings for Buffett

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If Warren Buffett was investing solely in Australia today he wouldn't find much to whet his appetite, local fund managers say.

A year ago, Smart Investor posed a hypothetical question to some of Australia's top fund managers: if Warren Buffett was Australian what stocks would he own?

It was a fitting time to ask. Last March, Buffett's Berkshire Hathaway reported a net profit of \$US4.2 billion for 2002, a 400 per cent increase on the previous year, at a time when innumerable fund managers both in the United States and Australia had been losing money consistently for two years.

Buffett's investment style looked bulletproof: keep it simple, go for well-managed and reasonably priced businesses that stick to what they know in easily understood businesses, and do so with good return on equity and low debt.

The market looks very different today, however, and Buffett has started making rather different noises about it.

It's not as if anything has gone wrong: the per-share book value of Berkshire's A and B shares rose by 21 per cent in 2003, but Buffett's letter to shareholders on February 29 detailing Berkshire's performance in 2003 noted "we've found it hard to find significantly undervalued stocks", which many observers have interpreted as meaning that US stocks are fully valued.

So it's time to ask the same question again: in a market that rose by 26 per cent between March 1, 2003, and February 29 this year, what would Buffett be looking at in the Australian market? What would his portfolio hold?

The answers are not encouraging. "If Warren Buffett was Australian and could invest only in Australia, he would be 100 per cent in cash," says MMC Asset Management portfolio manager Erik Metanowski — and he's only half joking.

Metanowski is one of a group of Australian managers who fete Buffett's investment style and have done pretty well as a consequence. Metanowski was the founder and chief investment officer of MMC, an Adelaide-based fund manager, before stepping down to a portfolio manager role after merging the business with AM Constable and making that operation's founder, Peter Constable, the chief investment officer.

His website is peppered with Buffettisms and his value style mirrors Buffett's. He's done well with it: \$100,000 invested in the MMC Value Growth Trust at its launch in 1993 would have been worth six times as much by June 2003, but Metanowski doesn't see a lot of value today.

"It's scary," he says. "There are a couple of things out there we have got pretty big investments in, but it is Russian roulette time as far as I'm concerned. Companies of very low quality are trading at prices that, if they were private companies, they could only dream of. You get a price-earnings multiple on the stock-market of three or four times what you would get if you were a private company trying to sell."

Clearly there are exceptions. MMC, for example, is well documented as a substantial shareholder in PMP, Australia's largest printing company. Metanowski calls it "a wonderfully managed business, generating a lot of cash. The whole scenario in that particular business has improved dramatically".

PMP is actually down by 7.14 per cent this year but has trebled in value since March 2003 and is

trading on a 12-month forward P/E ratio of 10.4 times, on Bloomberg's numbers. Its return on equity is 11.76 per cent.

Another MMC investment is Reinsurance Australia Corp, although it has risen by 22.35 per cent this year and therefore might not be the bargain it once was.

Peters MacGregor Capital Management is another Australian fund manager in the Buffett fan club. Its marketing literature says: "Our approach and philosophy have been crafted from the teachings of Professor Benjamin Graham and his most acclaimed student Warren Buffett."

Until recently, Peters MacGregor has served only clients with \$2 million or more to invest, although it is marketing a listed investment company that will allow pretty much anyone in. So far it has raised more than \$70 million.

The fund is renowned for its policy of concentration. At times it has owned only seven stocks and it hasn't bought a new one this financial year.

It also takes pickiness to an extreme, and it's little surprise to learn that chief investment officer Wayne Peters can't find any value today either. "We're certainly struggling to find opportunities in the North American and Australian markets," he says. The fund has no Australian holdings at the moment.

"It's not that there's not some great companies here, it's just that values are very high," Peters says.

Still, Peters MacGregor argues that the comments attributed to Buffett saying the markets are overvalued misses the point; in fact, he was saying there weren't any good value companies big enough for him to invest in.

Berkshire Hathaway rarely invests less than \$US500,000,000 (\$664,700,000).

Although they are not necessarily great value today, Peters can identify several Australian companies that fit Buffett's other criteria. He points to Westfield Holdings and Harvey Norman as examples. Both companies hit all the Buffett buttons, bar price.

They have strong brand names in relatively simple businesses and their management is admired. Bloomberg puts Westfield's return on equity at 18.71 per cent and Harvey Norman's at 17.05 per cent. Neither company is worryingly encumbered by debt and both have stable earnings growth.

These names are also mentioned by John Price, a visiting professor of mathematics and finance at the University of NSW, who is also chief executive of Conscious Investor, a software developer that filters information on Australian and US companies in a Warren Buffett style.

"Following Warren Buffett, the sort of things that we look for are strong and stable growth in sales and earnings, not too much debt, high return on equity and a clear competitive advantage," he says.

"I've talked about stocks like ARB [a bullbar manufacturer], Harvey Norman, HNG and Westfield Holdings. It does not mean that you should buy them at any price, but you certainly should consider having your money ready. Every now and then Mr Market offers to sell them to you at attractive prices."

"Mr Market" is a concept first expressed by Graham and subsequently written about at length by Buffett: it's the idea that one should imagine market quotations as coming from a person — Mr Market — who is your partner in a private business, who every day names a price at which he will either buy your interest or sell you his.

An emotional chap, sometimes Mr Market will see only the good side of a business and at other times be miserable about it, regardless of what's really the case.

“Mr Market is there to serve you, not to guide you,” wrote Buffett in 1988. “It is his pocketbook, not his wisdom that you will find useful.”

Price adds that looking at valuations today isn’t necessarily the whole story. “The trouble with value investing is that it so boring,” he says. “Most people like to be diving in and out of the market, trying to pick trends or market tops and bottoms. With value investing, time is taken up with quietly looking for quality companies selling at reasonable prices. Once an investment is made, then you let the price be driven by growth in sales and earnings.”

Another Buffett trait is to look for the unloved: solid companies that have fallen on hard times but that ought to bounce back eventually, based on their fundamentals.

Anton Tagliaferro, chief investment officer of Investors Mutual, has long been a fan of Brambles based on this logic. Earlier this year he told Smart Investor: “It owns three very good businesses which are well positioned to grow their earnings over the next 10 to 20 years.”

It’s perhaps a sign of the buy-and-hold ethics of Buffett-style value managers that the stocks named this year are in many cases the ones named last year. Then, the names that came up included Harvey Norman, Westfield Holdings, ARB and Brambles. The market is still waiting for the unloved Brambles to turn around, but otherwise those names have done well.

The other names mentioned last year have turned out to be a mixed bag of success stories (Computershare up 110.18 per cent in a year, Perpetual Trustees 57.16 per cent), solid plodders (Telstra 21.85 per cent, Leighton Holdings 16.55 per cent), laggards (Burns Philp exactly flat year on the year, Flight Centre down 3.8 per cent) and several big disappointments: Tempo, down 20.83 per cent, and Cochlear, down 40.81 per cent.