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Buffett Delights in Brazil-China: Real M&A

Warren Buffett's search for deals in Brazil and China may put companies from Marcopolo SA (POMO3) to Odontoprev SA (ODPV3) and Lonking Holdings Ltd. (3339) on his wish list.

By **Tara Lachapelle, Rita Nazareth and Margaret Collins**

SÃO PAULO - The 80-year-old billionaire investor and chairman of Omaha, Nebraska-based Berkshire Hathaway Inc. (BRK/A) said at a news conference on May 1 after its shareholder meeting that Brazilian companies are on his “radar screen” and that he would be “delighted to buy businesses in China” as well as Hong Kong. Buffett’s comments came less than two months after he agreed to purchase Wickliffe, Ohio-based Lubrizol Corp. for about \$9 billion.

The world’s most successful investor is looking outside the U.S. with emerging economies forecast to grow twice as fast as developed nations and near-zero percent interest rates limiting returns in fixed-income markets. Marcopolo, Brazil’s biggest busmaker, Odontoprev, the country’s largest provider of dental plans, and Lonking, one of China’s biggest makers of construction equipment, are among 27 companies from Brazil and China that meet the acquisition criteria listed in Buffett’s annual report, according to data compiled by Bloomberg.

“One of the reasons he’s been traveling the globe is to try to find something that makes sense that he can understand in growing economies,” said Barry James, who oversees \$2.5 billion as president of James Investment Research Inc. in Xenia, Ohio. “It’ll probably be in the next year or two that he’ll be doing some of these international deals.”

His James Balanced Golden Rainbow Fund has beaten 94 percent of competitors in the past five years.

First Takeover

Buffett didn’t return a request for comment e-mailed to his assistant, Carrie Kizer.

A takeover in either Brazil or China of a publicly traded company would be a first for Berkshire, which has struck at least \$50 billion of acquisitions in the U.S. in the past decade for public companies, according to data compiled by Bloomberg.

Berkshire owns a stake in BYD Co., the Shenzhen, China- based automaker, through its MidAmerican Energy Holdings Co. unit. Shares of BYD had more than tripled through

yesterday since Buffett agreed to buy 225 million shares of the company in September 2008.

Economies in emerging markets will grow 6.5 percent in 2011, according to estimates from the Washington-based International Monetary Fund. That compares with 2.4 percent for developed nations. China, the world's fastest growing major economy, will expand by 9.5 percent in 2011, according to the median of 11 economists' estimates compiled by Bloomberg.

'Delighted'

"We'd buy businesses in Hong Kong," Buffett said at the press conference on May 1 in Omaha, Nebraska, a day after Berkshire's annual meeting of shareholders. "We're delighted to buy businesses in China too."

Buffett typically prefers "simple" businesses with pretax profit exceeding \$75 million, "consistent" earning power, and "good" returns on equity while employing little or no debt, according to his annual letter to shareholders on Feb. 26.

He has shifted his takeover strategy as Berkshire has grown to focus on "capital intensive businesses," such as power producers and railroads, which require consistent investment in infrastructure and equipment.

Buffett, who agreed to buy Lubrizol in March, said at Berkshire's annual meeting that "we can't do a really big elephant now." Lubrizol was recommended to Buffett by David Sokol, former chairman of Berkshire's MidAmerican Energy unit.

Sokol, 54, who resigned on March 30, violated Berkshire's insider-trading rules and misled the company about his personal stake in Lubrizol, Berkshire's audit committee said last week.

'Ideas Anyplace'

Berkshire, which usually keeps at least \$20 billion in cash on hand, had about \$38 billion at the end of the first quarter, according to Buffett.

There are 27 companies from Brazil and China with market values from \$1 billion to \$15 billion that have capital expenses accounting for at least 5 percent of their net fixed assets; a return on equity exceeding 10 percent; profit growth in the past five years that ranked in the top 50 percent; and an average price-earnings ratio in that span that was less than the average company in the MSCI Emerging Markets Index, according to data compiled by Bloomberg.

So-called value investors such as Buffett also purchase companies when their stock prices are low by historical standards when compared with earnings.

“We don’t go looking in specific countries. We are looking for ideas anywhere,” Buffett said at the May 1 press conference. “Most of our opportunities will come in the United States. Whether it’s three out of four or whatever it may be.”

Empire Building

Berkshire, which has a market capitalization of \$204 billion, owns 10 insurers including Geico and more than 60 other companies from food distributor McLane Co. and clothing-maker Fruit of the Loom to toolmaker Iscar Metalworking Cos. and utility MidAmerican Energy.

Marcopolo, with a market value of 3 billion reais (\$1.9 billion), has traded at an average of 11.2 times profit in the past five years, 84 percent cheaper than the average company in the MSCI Emerging Markets Index of 21 developing countries, data compiled by Bloomberg show. The Caxias Do Sul, Brazil-based company’s return on equity, a measure of how much it earns for each dollar invested, doubled to 35 percent last year. That compares with 21 percent for MSCI’s developing markets gauge.

Net income for the maker of bus frames and bodies more than doubled to 296.5 million reais last year as the 62-year old company’s comparable sales increased 44 percent.

Marcopolo’s external press office in Sao Paulo didn’t respond to a telephone call and an e-mail seeking comment.

‘A Big Country’

“The more mobile people are, the more they are going to need additional transportation,” said Peter Sorrentino, who helps oversee \$14.4 billion at Huntington Asset Advisors in Cincinnati. “Brazil is a big country. You have a lot of distances to cover and not necessarily a lot of airport access. That’s a nice business that would fold in well.”

Berkshire’s recreational vehicle maker Forest River Inc. includes divisions such as Starcraft Bus, which makes shuttle and school buses.

Shares of Marcopolo rose 2.4 percent to 6.96 reais in Sao Paulo today.

Odontoprev, the dental-plan provider with a market value of \$2.93 billion, reported 219 million reais in earnings last year, a 12-fold increase from 2005, according to data compiled by Bloomberg. The Barueri, Brazil-based company’s return on equity was 28 percent last year, higher than the average for the 809- company MSCI Emerging Markets Index, the data show.

Net income also increased more than 95 percent of companies in the gauge in the past five years.

‘An Honor’

Its shares, which reached a record high in November, have climbed 81 percent in the last 12 months, compared with a 4.2 percent decline in Brazil's Bovespa Index and an 18 percent gain in MSCI's emerging markets gauge.

Odontoprev advanced 2.7 percent to 26.95 reais today.

The stock was raised to "buy" in February by Daniel Gewehr, a Sao Paulo-based analyst for Banco Santander SA, who said job creation and low unemployment will boost plan enrollment. Brazil's jobless rate fell to a record 5.3 percent in December, according to the national statistics agency.

"It would be an honor and a privilege to have the acknowledgement of Mr. Buffett's management team," Jose Roberto Pacheco, investor relations officer for Odontoprev, said in an e-mail. The company hasn't been contacted by Buffett, he said.

MetLife Inc. of New York, the largest U.S. life insurer, purchased Odonto A Saúde Empresarial in 2008 to enter Brazil's dental insurance market.

"We're waiting for a call," Buffett said during the May 1 press conference, referring to opportunities in Brazil.

"Brazil itself is doing extraordinary," he said. "I got offered a big deal in Brazil some time ago, but the price did not make any sense."

Wheel Loaders

Brazil's gross domestic product increased 7.6 percent last year, more than double the U.S.'s 2.9 percent growth, according to data compiled by Bloomberg.

China's Lonking, which had an average price-earnings ratio of 12.4 times over the past five years, increased net income more than sevenfold in the same span, data compiled by Bloomberg show. Analysts now project revenue at the Shanghai-based company will top \$2.5 billion for the first time next year.

A representative from Lonking's investor relations department declined to comment.

Lonking, which started in 1993 and currently has a market value of \$2.95 billion, has sold more wheel loaders than any other company in the world since 2006, according to its website. Wheel loaders are used to scoop and load material at quarries and construction sites.

Its return on equity was 39 percent last year, almost twice as much as the average company in the MSCI Emerging Markets Index, data compiled by Bloomberg show.

'Big in China'

"There's going to be an enormous amount of infrastructure projects going forward and there's a preference for the Chinese to buy their own products," said Thomas A. Russo,

who manages about \$4 billion at Gardner Russo & Gardner in Lancaster, Pennsylvania. “Those businesses are going to be really big in China and Lonking may enjoy a favored status. It could make sense for Buffett.”

Goldman Sachs Group Inc. of New York in January recommended that investors buy shares of Lonking because China’s urbanization will drive demand for construction machinery. The stock has climbed 87 percent in dollar terms in the past year. The stock fell 4.3 percent to HK\$5.34 today.

Overall, there have been 8,347 deals announced globally this year, totaling \$827.3 billion, a 24 percent increase from the \$669.3 billion in the same period in 2010, according to data compiled by Bloomberg.

List of Companies:

Companies based in Brazil, China and Hong Kong

Trade in Hong Kong or Sao Paulo

Market Capitalization from \$1 Billion to \$15 Billion

Capital Expenditures / Net Fixed Assets > 5%

Return on Common Equity > 10%

5-Year Net Income Growth in Highest 50%

5-Year Average P/E Ratio < MSCI Emerging Markets Index Average

Company Value

Sorted by Market Capitalization

*Excludes Banks, Information Technology and Biotechnology

Companies

Brazil:

Cia. Hering

Odontoprev SA

M. Dias Branco SA

Rossi Residencial SA

Marcopolo SA

Grendene SA

Drogasil SA

China:

China National Building Material Co.

Gome Electrical Appliances Holding Ltd.

Jiangsu Expressway Co.

Golden Eagle Retail Group Ltd.

Guangzhou R&F Properties Co.

Parkson Retail Group Ltd.

ENN Energy Holdings Ltd.

Shui On Land Ltd.

Li Ning Co.

Xingda International Holdings Ltd.

Minth Group Ltd.

Hong Kong:

China Resources Land Ltd.

Nine Dragons Paper Holdings Ltd.

First Pacific Co.

Minmetals Resources Ltd.

Lee & Man Paper Manufacturing Ltd.

Lonking Holdings Ltd.

Geely Automobile Holdings Ltd.

China Everbright International Ltd.

Lee & Man Holding Ltd.

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