Kraft Heinz Co

Warren Buffett heads for exit at pivotal moment for Kraft Heinz

Investors start to question Midas touch of 3G, the private equity firm that part controls the company

The Sage of Omaha's break from Kraft Heinz, which was created through a $100bn deal orchestrated by Mr Buffett and 3G Capital, has sparked speculation about the investor's relationship with the private equity group © FT montage / AP

Scheherazade Daneshkhu in London, Eric Platt and Sujeet Indap in New York 2 HOURS AGO

Warren Buffett on Monday will step down from the board of Kraft Heinz after five years, leaving the food group in which his Berkshire Hathaway investment company has a 27 per cent stake, with an uncertain future.

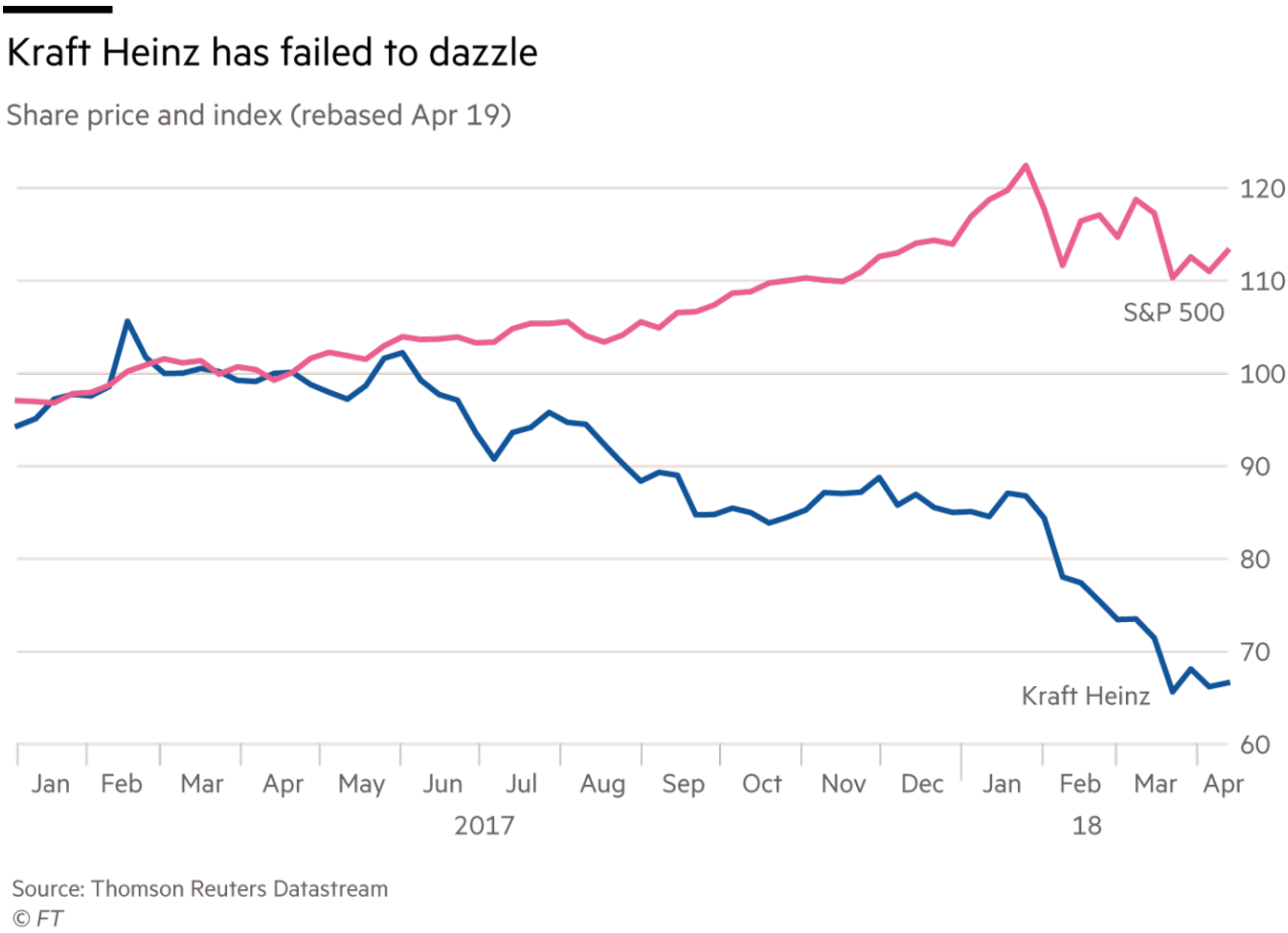
The 87-year-old made the announcement in February — almost exactly a year after Kraft Heinz's failed $143bn bid for Unilever — giving his reason as a wish to travel less.

His departure comes at a pivotal time for Kraft Heinz and has raised questions about his relationship with 3G Capital, the New York-based private equity group founded by Jorge Paulo Lemann that is the other major shareholder.

Mr Buffett told the FT: "My stepping down from the board represents no change of any kind in my or Berkshire's relationship with 3G. I am on no public boards (except Berkshire) and expect to be on none in the future."

Kraft Heinz has had a miserable year since the thwarted Unilever bid — its most recent quarterly earnings disappointed and its shares have slid by 30 per cent year-on-year.

"There is no question that our financial results in 2017 did not meet our potential," acknowledged Bernardo Hees, chief executive in February.



Though Mr Hees talked about a step-up in investment and the potential for organic growth, some analysts appear unconvinced. They believe that another M&A deal might be getting closer, while fearing for the consequences if Kraft Heinz fails a second time.

"Organic growth is not Kraft Heinz' expertise", said analysts at Credit Suisse in a recent note. "We harbour serious doubts about the management team's ability to generate sufficient product innovation to grow its collection of retro brands in highly-commoditised categories."

Mr Lemann, Brazil's richest man, has been a friend of Mr Buffett since the two met on the board of Gillette 20 years ago. Mr Lemann and Marcel Telles, another of the three Brazilian men who founded 3G, are also on the Kraft Heinz board.

In many ways, Mr Buffett and Mr Lemann are one of the corporate world's more unlikely pairings.

The Sage of Omaha cultivates a cosy, avuncular image as a friendly investor who cherishes incumbent management. But 3G Capital, set up by Mr Lemann after making a fortune at Anheuser-Busch InBev, has a reputation for buying businesses, throwing out managers — 11 of the top 12 Heinz executives left on one day — and ruthlessly slashing costs.

In other ways, they are well-suited: to start with, folksy elder statesman Mr Buffett gave the Brazilian group instant credibility in the US.

Jorge Paulo Lemann, Brazil's richest man, has been a longtime friend of Mr Buffett, but the two have very styles and corporate reputations © AFP

Moreover, Mr Buffett's hunt for "elephant" deals was well-matched by 3G's formidable ambition.

Mr Buffett wrote in his 2015 letter to Berkshire shareholders: "I knew immediately that this partnership [with 3G] would work well from both a personal and financial standpoint."

However, Mr Buffett did not come cheap for 3G. The $8bn of preferred stock Berkshire Hathaway invested originally in Heinz earned a whopping 9 per cent dividend. (Berkshire separately invested a total of nearly $10bn in Kraft Heinz common equity.)

The $3bn Berkshire provided to fund 3G's purchase of coffee and doughnut chain Tim Hortons also paid 9 per cent.

Mr Buffett and 3G teamed up in 2013 to buy Heinz and then took it public again when they merged it with Kraft in 2015. But it was third time unlucky when it came to Unilever in 2017.

Mr Buffett admitted pulling the plug on that acquisition in the face of fierce resistance from Unilever, which went against his mantra of friendly deals.

"It became very apparent that Unilever did not want the offer. I got calls that it was unwelcome, and I said: if it's unwelcome, there's no offer," Mr Buffett told CNBC, soon afterwards.

Adding that English was the second language of Alex Behring, Kraft Heinz's Brazilian chairman and 3G chief executive, Mr Buffett said: "I've seen misunderstandings before — that's one reason why I like to do it the way I do it. I say: I'll make you an offer if you want one."

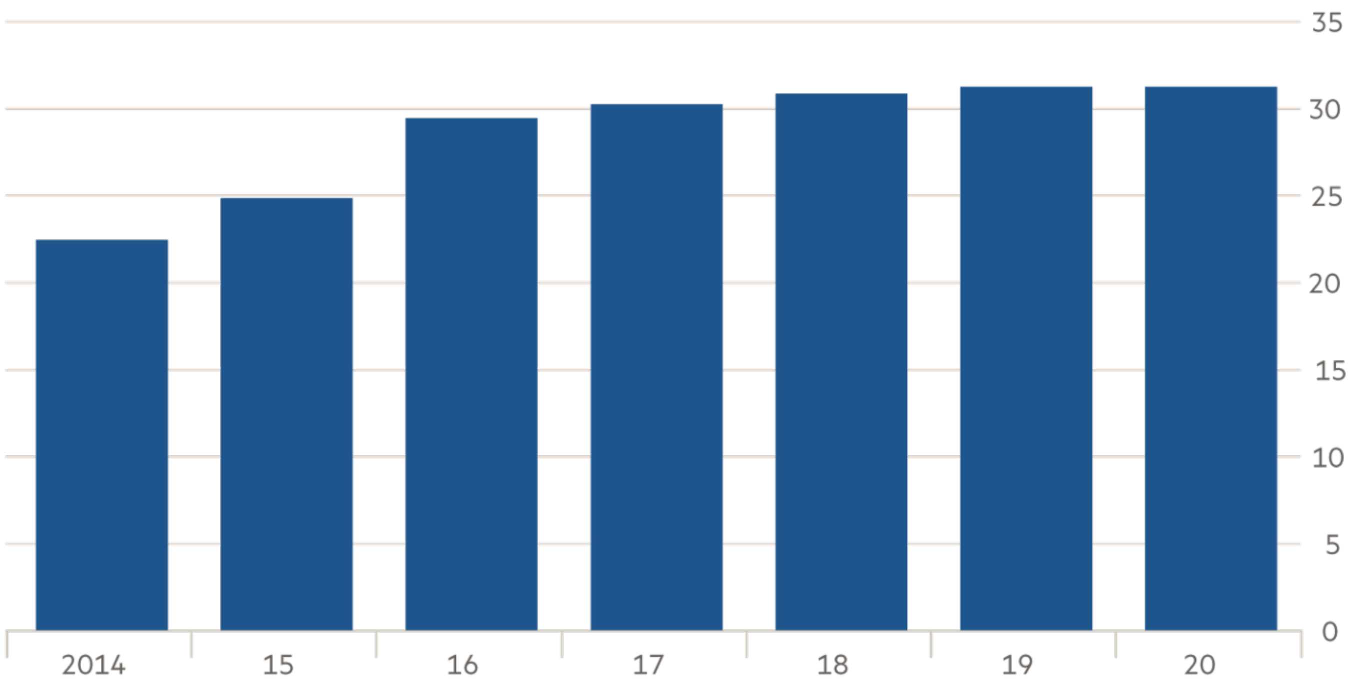
More recently, Mr Buffett and Kraft Heinz appear to hold different views about the investment climate. Mr Buffett said in this February's shareholder letter that valuations "proved a barrier to virtually all the deals we reviewed in 2017 as prices for decent, but far from spectacular businesses, hit an all-time high".

Only a few weeks earlier, Mr Hees told analysts that: "valuations today are more attractive than they were even two months ago. And the chapter of Kraft Heinz integration is behind us."

Given that both are keen dealmakers, these differing views on valuations, as well as Mr Buffett's opposition to more hostile deals, could be blocking 3G's M&A ambitions for Kraft Heinz.

Kraft has cut to the bone to generate huge margins

Ebitda margin (%)



Source: Société Générale
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Alexia Howard, analyst at Bernstein said: "Some investors have interpreted Buffett stepping down from the Kraft Heinz board as that Kraft Heinz could be inclined to go after a hostile deal. I don't know what their intentions are but at the margin, it seems as though it may be more possible than it was with Buffett on the board."

The pair's dealmaking ambitions may have also been upended by their own success.

Most of the large packaged consumer food companies, such as General Mills and Kellogg, have defensively initiated their own heavy cost-cutting programs to try to pre-empt shareholder activism or an unsolicited knock on the door.

Nevertheless, Mondelez is often cited by analysts as the best substitute for Unilever. Like the Anglo-Dutch company, a large proportion of its sales are to emerging markets and it has well-known brands, including Oreo biscuits and Cadbury chocolate.

One person familiar with the situation said that 3G had teed up a deal, only to have it upended by the election of Donald Trump. Mr Trump's protectionist rhetoric and willingness to target specific companies would have made cost cuts and plant closures tricky.

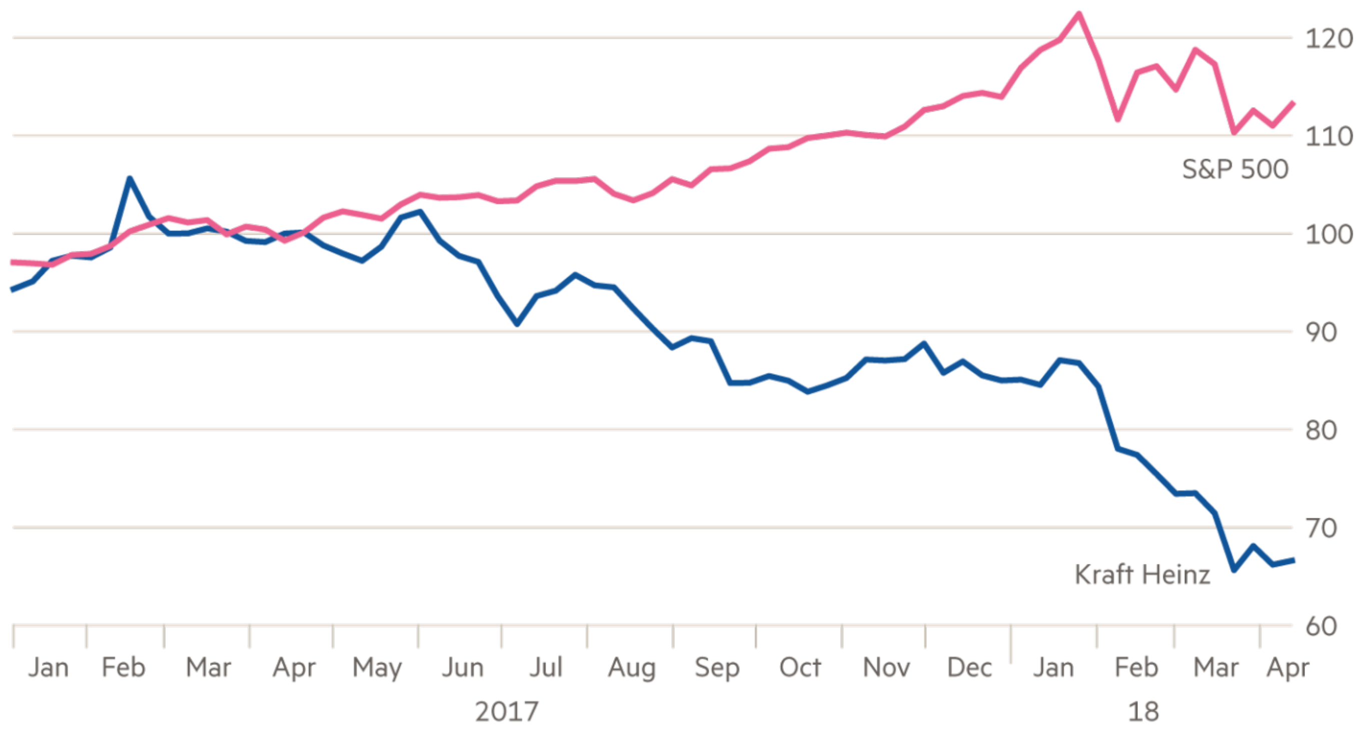
But when asked last September whether Kraft Heinz would buy Mondelez, Mr Buffett said: "I think the answer is no."

If 3G still hopes to bid for Mondelez, it could be easier with Mr Buffett no longer on the Kraft Heinz board. Nevertheless, Berkshire Hathaway does still have two board seats, including long-time Berkshire executive Greg Abel, who is vice-chairman.

Mr Buffett is being replaced by Alexandre Van Damme, who is close to 3G's founders. He is on the board of AB InBev and Restaurant Brands International, through which 3G owns Tim Hortons and Burger King.

Kraft Heinz has failed to dazzle

Share price and index (rebased Apr 19)



Source: Thomson Reuters Datastream
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Though Credit Suisse analysts see Mondelez as a likely target, they also believe hostile bids are unlikely: "Our sense is that Kraft Heinz and 3G still view a hostile deal as a last resort and that it remains aligned with Berkshire's views."

Without Mr Buffett's firepower — Berkshire has $116bn in cash and Treasury bills, according to his latest annual letter — 3G looks unlikely to be able to manage a huge deal, such as PepsiCo, which is also seen as a target.

Kraft Heinz's share slide has also reduced its purchasing power. The company's valuation multiple has fallen to a 5 per cent discount from a 16 per cent premium in February 2017, meaning it would need to issue 45 per cent more shares if it wanted to buy Mondelez for shares, according to Credit Suisse.

Mr Buffett may still be happy to back Kraft Heinz financially. "Berkshire Hathaway may lower its profile in future Kraft Heinz deals, maybe participating via preferred stock but not necessarily contributing equity to future levered-acquisitions," said Pablo Zuanic, analyst at Susquehanna International.

A person who knows Mr Buffett said: "He really cares about his image as Uncle Warren. I think he'll do more deals but he doesn't need to sit next to them in the public eye. It's one thing to sit next to someone and it's another to invest with them."

A well-paid partnership for Berkshire

Warren Buffett's relationship with 3G has been "highly lucrative" for Berkshire Hathaway even with the weakness in Kraft Heinz shares over the past year, according to Jay Gelb, an analyst at Barclays.

Berkshire invested $4.4bn alongside 3G when the two teamed up to take Heinz private in a $28bn deal in 2013.

The sprawling investment conglomerate lent $7.7bn to buy preferred stock as part of the deal, which paid Berkshire $720m a year in interest and was redeemed by the company in 2016. Mr Buffett invested a further $5.3bn when Heinz swallowed Kraft in a deal announced in 2015.

The value of that near $10bn equity investment in Kraft Heinz surged to nearly $30bn in 2016, but has tumbled alongside the company's 34 per cent share price decline over the past 12 months.

James Shanahan, an analyst at Edward Jones, put the current fair value at just under $20bn, roughly $2bn above the carrying value that Berkshire has on its books.

The company still earns dividends of roughly $800m a year from its Kraft Heinz investment.

"You can call it a win but the substantial decline in the Kraft Heinz share price recently ... has cut into their economic value created in this transaction," Mr Shanahan said.

Berkshire and 3G also teamed up when Burger King took Tim Hortons private, with Berkshire lending $3bn to the company at a 9 per cent interest rate. The company paid off that obligation last year.

Eric Platt in New York