HollAnd Advisors

Holland Views: Berkshire Hathaway (Buy) A's $320K, Mcap $530bn

A buy for Value and Franchise seekers alike

For many years now we have annually modelled the value of Berkshire Hathaway (BRK). Doing so to see whether the entity represented good value not just versus a prudent valuation of its constituent parts today but also against the likely future growth it might deliver to investors in the future. Whilst we are fans of Munger and Buffett's approach to business and investing we have always tried to remain dispassionate when assessing the company's value. As such we have endeavoured to be disciplined in our valuation work only recommending the company as a buy when we saw a valuation anomaly. **Today looks to be one such moment.**

In the attached slide presentation, we show a variety of charts which explain our current and past thinking on BRK's value. (These are the outputs of a model which we are happy to share). We conclude that for the first time in a number of years Berkshire looks cheap vs. the consistent value yardsticks we have been measuring the company on for almost ten years now. Adjusting for today's lower share prices of its owned securities but also putting a 17x multiple on controlled businesses (ex insurance) gives us a best guess valuation range of **$329,000-$408,000**. **Buy Berkshire.**

What our slides show

This note is intended to accompany our slides and model on Berkshire Hathaway. To understand our approach best, it is best looked at accompanying either, or preferably both.

Simply put the attached slides show:

- That Berkshire has traded very closely to our modelled range of values for the company over a very long period. Our intrinsic valuation has compounded at 11% on average over the last nine years. This we think is a reasonable proxy for its long-term growth.
- That today using this exact same approach of a 'Prudent' and 'Optimistic' values gives a suggested fair value for BRK of between $309K and $388k per each A share. However:
  - This is a backward-looking estimate using December 2019 financials, so it does not take into account any owned business growth happening in 2020 nor does it factor today's lower share prices of owned securities
  - Crudely adjusting for today's values for its owned market securities **only,** this range might reduce to $280k to $359k
- Additionally, using Buffett's own view on valuation (expressed a few years ago) would give a value of:
  - $393k per share
  - And this in turn would be reduced to $380k, again crudely adjusting for today's lower share prices

But… are we too prudent?

We are delighted that the BRK price has closely mirrored our consistent valuation approach suggesting it is a very useful method for investors to decide when to/not to buy BRK stock. However, we also think as time has evolved, our approach perhaps ought to have evolved a little too.

Ergo:

- The owned businesses we have valued using a 10x PBT multiple every year for the last decade. Doing so at the time we started our work this equated into a not unreasonable multiple of c.15x PE when corporate tax rates were 33%. However:
    - At a 20% tax rate a 10x PBT multiple equates to a PE of 12.5x!!
    - At the same time the price of high-quality businesses has been rated ever higher in Equity markets making this 'look-through PE' seem more and more unrepresentative of the generally high ROIC businesses that Berkshire controls
    - Indeed, nowhere is this truer than in the railroads and utility space where such predictable businesses now sit on c.20x PE multiples.
- Adjusting our valuation for:
    - Stock valuations to today's prices (we assume whole portfolio -10% YTD)
    - …AND a c.17x implied PE (c. 13.6x PBT) multiple for owned businesses
    - Results in a new range for the value of **Berkshire today of $329k to $408k**

This range of $329k to $408k we think is a better guide to the real value of the assets sitting inside Berkshire today. We remind readers that the range of values we have is created by either assuming the whole cost of the float liability is deducted from investments or none of it is. The debate on which of these is the correct approach is a long one for nerdy BRK watchers, thus we think the range of values is a useful to bypass of it.

Reflecting on Optionality and Mortality

In previous valuation exercises for BRK we have sometimes noted the risk of Buffett's inevitable mortality and how news of his death might bring uncertainty and some risk to the share valuation. Whilst we still feel that is a relevant argument as he will not create easy shoes to fill, the value in BRK today provides some good comfort to that overhang. Today in contrast we see possible upside optionality in the company. This is in part due to the fact that his and Charlie's golden touch has arguably created little value for the group in recent years (Ref. Heinz deal), but more due to the collection of other assets the group is now sitting on.

- Of our fair value estimate a remarkable 23% of which is currently in cash. Whilst that will limit compounding potential of Berkshire's intrinsic value in its current form recent market volatility points to the optionality it brings particularly inside such a parent. For an example see our recent reflections on Aercap. It is the perfect example of a business that *could* fail as a separate entity, but would never do so as part of a huge parent. Were someone like Aercap to fail there will be few buyers for its fleet, but we would expect Berkshire to interested.
- Additionally, in the quoted security portfolio Berkshire is a huge owner of arguably the two most depressed sectors in the world judged on earnings power/ROIC vs. Equity value. These being **Banks and Airlines:**
    - Banks and Airlines represent c.$52k/share or c15% of our estimate of BRK's value.
    - If they recover strongly over the longer term as we expect then BRK will be a strong beneficiary

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