Buffett Cash Makes General Mills to Grainger Targets: Real M&A
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(For more on the Heinz deal, visit EXT5 <GO>.)

By Tara Lachapelle
Feb. 15 (Bloomberg) -- The $23 billion takeover of H.J. Heinz Co. isn't enough to sate billionaire Warren Buffett.
Buffett's Berkshire Hathaway Inc. has about $15 billion in cash left for deals -- a figure that grows monthly -- after committing $12.1 billion for Heinz. With Buffett saying yesterday his desire for "elephants," or large acquisitions, remains unsatisfied, the world's fourth-richest person could set his sights next on targets from Cheerios maker General Mills Inc. to hardware supplier W.W. Grainger Inc.
Buffett has built Berkshire into a holding company with $246 billion in market value through acquisitions of railroads, insurers, newspaper publishers, clothing companies and now ketchup. General Mills, with iconic food brands from Yoplait yogurt to Pillsbury cookie dough, and Grainger, which sells power tools and office equipment, are among 28 U.S. companies between $15 billion and $35 billion in market value that meet the takeover criteria in Berkshire's annual report, according to data compiled by Bloomberg. Hershey Co., the maker of Kisses and Reese's candies, also makes the cut.
"He certainly has the capital to do another deal," Matt McCormick, who helps oversee $7.5 billion as a money manager at Cincinnati-based Bahl & Gaynor Investment Counsel Inc., said in a telephone interview. "He likes companies in this realm of name-brand products that have economic moats, consistent earnings, strong free cash flow and a reasonable valuation."

Heinz Ketchup

Buffett, the 82-year-old chairman and chief executive officer of Berkshire, didn't respond to an e-mailed request for comment sent to an assistant.
Berkshire and 3G Capital, the New York investment firm backed by Brazilian billionaire Jorge Paulo Lemann, will pay $72.50 a share for Heinz, 20 percent more than the stock's closing level on Feb. 13.
In addition to cash from Omaha, Nebraska-based Berkshire, the purchase will be financed with cash from 3G affiliates, plus the rollover of existing debt. The deal is valued at about $28 billion including debt, according to yesterday's statement.
Buffett, in the statement, cited Heinz's brands, management and "strong, sustainable growth potential." The Pittsburgh-

based maker of Heinz ketchup, Ore-Ida frozen French fries and other foods had sales increases in four of the past five fiscal years and is projected by analysts to post record annual revenue and profit for the period ending in April, according to data compiled by Bloomberg.

‘Right Brand’

“Buffett’s willing to pay a premium for the right brand,” Walter Todd, who oversees about $950 million as chief investment officer of Greenwood Capital Associates LLC in Greenwood, South Carolina, said in a phone interview. “It’s a combination of what he looks at financially and also qualitatively.”

Buffett told CNBC yesterday that Berkshire’s cash balance was about $47 billion at the end of 2012, up from $37.3 billion a year earlier. He prefers to keep $20 billion in reserve, leaving about $15 billion following the Heinz transaction, which a filing yesterday shows is costing Berkshire $12.1 billion.

“I’m ready for another elephant,” he said during the CNBC interview yesterday. “If you see any walking by, just call me.”

“The cash builds from month to month, so the gun is always getting reloaded,” Buffett said.

Buffett usually prefers “simple” businesses, “consistent” earning power and “good” returns on equity while employing little or no debt, according to his annual report.

Takeover Criteria

He has shifted his takeover strategy as Berkshire has grown to focus on “capital intensive businesses.” So-called value investors such as Buffett also purchase companies when their stock prices are low by historical standards compared with earnings.

There are 28 U.S. companies with equity values between $15 billion and $35 billion that had capital expenses accounting for at least 10 percent of net fixed assets; generated an average increase in return on invested capital in the past five years that ranked in the top 50 percent; sold for a lower price-earnings ratio than the average stock in the U.S.; and had a return on equity last year exceeding 10 percent, data compiled by Bloomberg show.

General Mills would be a fitting takeover for Buffett after the Heinz purchase because both companies have recognizable brands and sell their products in many of the same stores, said Jeff Matthews, a Berkshire shareholder and Naples, Florida-based author of “Warren Buffett’s Successor: Who It Is and Why It

Matters."

General Mills

"General Mills makes a lot of sense," Matthews said in a phone interview. "It's another kind of sleepy, Heinz-type business that has a lot of potential. The distribution channels really overlap."

The company increased its return on invested capital -- a measure of how profitably a company uses its debt and equity -- by an average of 6.2 percent over the past five years, data compiled by Bloomberg show. General Mills also generates more free cash flow relative to its stock price than 94 percent of the world's largest food manufacturers, the data show. It has a market value of almost $29 billion and net debt of about $7.6 billion.

General Mills would rival the takeover of Burlington Northern Santa Fe Corp. as Berkshire's biggest deal.

Kirstie Foster, a spokeswoman for Minneapolis-based General Mills, said the company doesn't comment on speculation.

Hershey Chocolate

Hershey, the $17.8 billion chocolate company founded in 1894, generated a return on invested capital of 28.6 percent in 2012, higher than all but about 5 percent of stocks in the Standard & Poor's 500 Index, according to data compiled by Bloomberg. CEO John P. Bilbrey plans to boost annual sales to $10 billion by 2017, from $6.6 billion last year, and surpass Mars Inc. to become North America's biggest confectionary maker.

Berkshire already owns a candy maker, See's Candies, and helped finance the purchase of Wm. Wrigley Jr. Co. by Mars in 2008. Last year, Buffett praised the business model of turning commodity ingredients into premium-priced products.

"'Buy commodities, sell brands' has long been a formula for business success," he wrote in his annual letter to shareholders last year. "It has produced enormous and sustained profits for Coca-Cola since 1886 and Wrigley since 1891."

Controlling Trust

The Hershey, Pennsylvania-based company is controlled by a trust that benefits the Milton Hershey School, which has a majority of the voting rights. After Hershey terminated a sale process in 2002, Pennsylvania passed a law allowing the state's attorney general to block a sale if it's "unnecessary for the future economic viability of the company," according to Hershey's annual report.

Jeff Beckman, a spokesman for Hershey, said the company doesn't comment on speculation.
Consumer packaged-goods companies are appealing because they can weather a weak economy, said Barry James, who helps oversee $3.5 billion as president of James Investment Research in Xenia, Ohio.
"They're not going to be as dependent on rapid economic growth to sustain them," said James, whose Golden Rainbow Fund beaten 94 percent of rival funds in the last five years.
Consumer stocks including Campbell Soup Co., General Mills and J.M. Smucker Co. advanced yesterday after the Heinz deal was announced. General Mills ended the day at $44.31, its highest closing price since at least 1980.

Grainger's Hardware

Buffett's investment in Heinz won't spark a stampede for deals in the industry, said James Neely, a Cleveland-based partner at consulting firm Booz & Co. who advises consumer products companies on mergers.
"The next deal that he does is just as likely to be in a very different sector," he said in a phone interview.
Grainger, the seller of hardware, office supplies and related equipment that posted record revenue and net income last year, is another potential target. The $15.7 billion company earned about 13 cents in operating profit for every dollar of sales in the latest 12 months, more than triple the median 3.9 percent margin among industrial supply distributors, according to data compiled by Bloomberg.
"Grainger would fit his criteria," Michael Mullaney, chief investment officer at Boston-based Fiduciary Trust Co., which manages $9.5 billion, said in a phone interview. It's "easy to understand what they do. Grainger is a very good service-oriented company. It's well-run."
Joseph Micucci, a spokesman for Lake Forest, Illinois-based Grainger, declined to comment.
Berkshire already owns Campbell Hausfeld, a maker of home improvement products such as paint sprayers, and Iscar Metalworking Cos., which makes metal cutting tools.
"I'm sure he'll pull off something else down the road," Matthews said. "He's generating about $1 billion of cash a month. He's looking for something that's going to be a good bet in the long run. You have to be prepared for anything from Warren Buffett."

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Market Capitalization from $15 Billion to $35 Billion
Capital Expenditures / Net Fixed Assets > 10%
5-Year Average Growth in ROIC in Highest 50%
P/E Ratio < Average Company Value in Home Market
Return on Common Equity > 10%
*Excludes Banks, Brokerages, Asset Managers, Technology,
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