A Buffet In A China Shop
Newsletter for December 2023

As the holiday season fast approaches, we decided to address the question which has long been on our minds: "What would Mr. Buffett do in China today?"

We begin by looking at the famous Buffett Indicator

The Buffett Indicator is the ratio of total US stock market value divided by GDP[1]. At one time, Mr. Buffett said that the ratio represents "the best single measure of where valuations stand at any given moment". While Mr. Buffett has since walked back those comments, hesitating to endorse any single measure as either comprehensive or consistent over time, this ratio, however, remains credited to his name.

Currently, the US stands at 175% (i.e. overvalued vis-a-vis history) compared to China's 57% (i.e. modestly undervalued vis-a-vis history) on this indicator. The US is 1.4X standard deviation above historical trend, while China is 0.5 standard deviation below trend.

Furthermore, over the last decade, using the Hang Seng China Enterprises Index (HSCEI[2]) yields an even lower Market Cap to GDP ratio for China as the Shanghai Composite Index (SSE Composite Index)[3] is up 41% vis-a-vis the HSCEI which is down 48% over that period.

Enough said, based on the above, the Buffett Indicator here would certainly have Mr. Buffett interested.

A Cheaper Geico & more?

PICC P&C (2328 HK), commanding a substantial 33% market share in FY22 by gross written premiums, stands as the foremost property and casualty insurer in China. Auto insurance underwriting contributed to nearly 60% of both PICC P&C's gross written premiums and the industry's total in 2022 (compared with Geico’s 13.4% US market share in 2021 as per data from S&P).

[1] https://currentmarketvaluation.com/models/buffett-indicator.php

[2] Hang Seng China Enterprises Index is a stock market index of The Stock Exchange of Hong Kong for H share (dual listed A share market & HK market), red chip (Mainland China majority Government-owned companies listed only in HK , and P Chip (controlled by private sector Chinese businessmen). https://en.wikipedia.org/wiki/Hang_Seng_China_Enterprises_Index

[3] The SSE Composite Index, also known as SSE Index, is a stock market index of all stocks (A shares and B shares) that are traded on the Shanghai Stock Exchange.

In early 2022, Warren Buffett set his sights on specialty insurer Alleghany Corporation, swooping in with an all-cash USD11.6 billion buyout offer. The purchase was done at a 25% premium and added approximately USD13 billion of valuable float to Berkshire Hathaway's coffers. Mr. Buffett paid 1.25X price-to-book ratio for Alleghany.

Compared to this, PICC P&C today, at a market cap of USD 25bn, is available at 0.8 P/B with an insurance float of around USD 50bn. Of course, a discount is warranted as the legendary risk management and investment skills of Mr. Jain and Mr. Buffett respectively would not be available. Nonetheless, the dominant auto insurance market share (60%), 2X insurance pool to market cap and 0.8X P/B would pique Mr. Buffett’s interest.

Matching up with the Saudi Arabia of Wind Energy[4]

Berkshire Energy (BHE) has rapidly grown to be number one in the US in ownership of wind-powered electric generation. 4.7GW or ~63% of BHE’s Renewable Generation of 7.4 GW comes from wind energy. In fact, Mr. Buffett said that Iowa is the Saudi Arabia of Wind Energy as over 55% of the megawatt-hours sold to the Iowa retail customers comes from wind energy.

Hidden in plain sight is China Longyuan Power (916 HK), with 26GW of wind energy capacity, a major wind power generator, which is available for 7.5X PE and at 0.6 X P/B. In fact, the company may take a leaf from Mr. Buffett's playbook as recent broker reports have suggested that the company may consider buying back their stock.[5]

Just like very few would know that Venezuela’s Orinoco Belt oil field represents around 5x the store of hydrocarbons vis-a-vis the storied deposits like Saudi's, Mr. Buffett would likely be aware and interested in the Orinoco of Wind Energy[6].

As American as Apple pie

To find an equivalent to Apple in China may be hard, given its unique qualities. Perhaps, Mr. Buffett's would follow his own adage - when you can’t be active, be passive!

[4] Berkshire Hathaway 2016 shareholder letter https://www.berkshirehathaway.com/letters/2016ltr.pdf
[5] A short write up from DBS - https://www.dbs.com.sg/private-banking/aics/templatedata/article/equity/data/en/DBSV/012014/916_HK.xml
[6] Orinoco Belt: A Heavy Oil Opportunity: https://pubs.usgs.gov/publication/fs20093028

The China Internet ETF, KraneShares CSI China Internet ETF (KWEB ETF), represents leading Chinese Internet companies, having remained unchanged (in aggregate) from their price ten years ago. KWEB would, perhaps, catch Mr. Buffett's fancy, especially given that his Apple investment has given him around a 3X return across his 7-year holding period.

"We own a lot of banks. I like banks as a business a lot. It's very easy to understand what they do. It's necessary, but there are excesses[7]."

Mr. Buffett's Bank of America (BAC) investment was made around the 2011 US Debt Ceiling Crisis. The contentious debate relating to the maximum amount of federal debt caused great fear in the stock market. BAC had rebounded handsomely post the GFC low of US2.53 (5-Mar-2009) to USD14.5 at the start of 2011. Mid-2011 as the debt ceiling debate in Congress came to a head, BAC was down over 50% to around USD7. Mr. Buffett followed his own advice and became greedy when others were fearful, and invested USD5bln in preferred shares which gave him ownership of warrants with the right to buy BAC at USD7.12. This investment has yielded more than a 4X return over the last twelve years.

With China going through its own real estate crisis, excesses we certainly have had! However, as we enter the third year of winding down excess in the China real estate market, China Merchant Bank (3968 HK), arguably amongst the better China banks, is down ~60% from its 2021 high at P/B 0.6X, PE of 4.26X LTM & 3.8X NTM and dividend yield of 7% (no need to extract concession to purchase preferred shares yielding 6% with warrant to purchase common shares here). Would Mr. Buffett think this is his "Bank of America" moment?

Not Petrochina this time

Having famously bought Petrochina (857 HK) in 2002 and sold it at 8X in 2007, Mr. Buffett would be eyeing CNOOC[8] (883 HK) at a dividend yield of 12%, FCF yield of around 30%, PE of 5X NTM, EV/EBITDA of 2.5X NTM, 6% CAGR 23-25 capacity growth and a net cash position. Occidental and Chevron have met their match, is perhaps what would be running through Mr. Buffett's mind.

This Bud is For You

Coke's (KO) stock total returns of 7.2% CAGR vs SPX 11.7% CAGR over the last ten years and Kraft Heinz's (KHC) -3.5% CAGR since purchase in 2015, have not exactly been blooming flowers. Budweiser APAC (1876 HK) and YUM China (YUMC), on the other hand, at multiples of 18X NTM consensus earnings with

[7] Q&A session of Berkshire's 2009 Annual Shareholder Meeting on May 2, 2009
[8] Of course, the current restrictions for US investors on purchasing CNOOC shares would need to be lifted, though.

faster earnings of over 15% over the next two years would likely whet his appetite, given KO's 21X and KHC's 12X NTM consensus earnings and slower earnings growth of 5% over the next two years and beyond.

"I like to go for cinches. I like to shoot fish in a barrel. But I like to do it after the water has run out.[9]"

A quick comparison of S&P 500 with MSCI China ETF (MCHI) shows the SPX trading at NTM PE of 21X, double that of MCHI's NTM PE of 10.5X, the widest gap seen over the last twenty years. Would Mr. Buffett consider this a cinch?

Of course, ultimately, what Mr. Buffett might do in China this holiday season and beyond is uncertain. However, what is certain that Mr. Munger will be missed. RIP Sir. You are legend!

[9] 2009 Berkshire Hathaway Annual Shareholders Meeting

Disclaimer

This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Information has been obtained from sources believed to be reliable. However, neither its accuracy and completeness, nor the opinions based thereon are guaranteed. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. This information is directed at accredited investors and institutional investors only