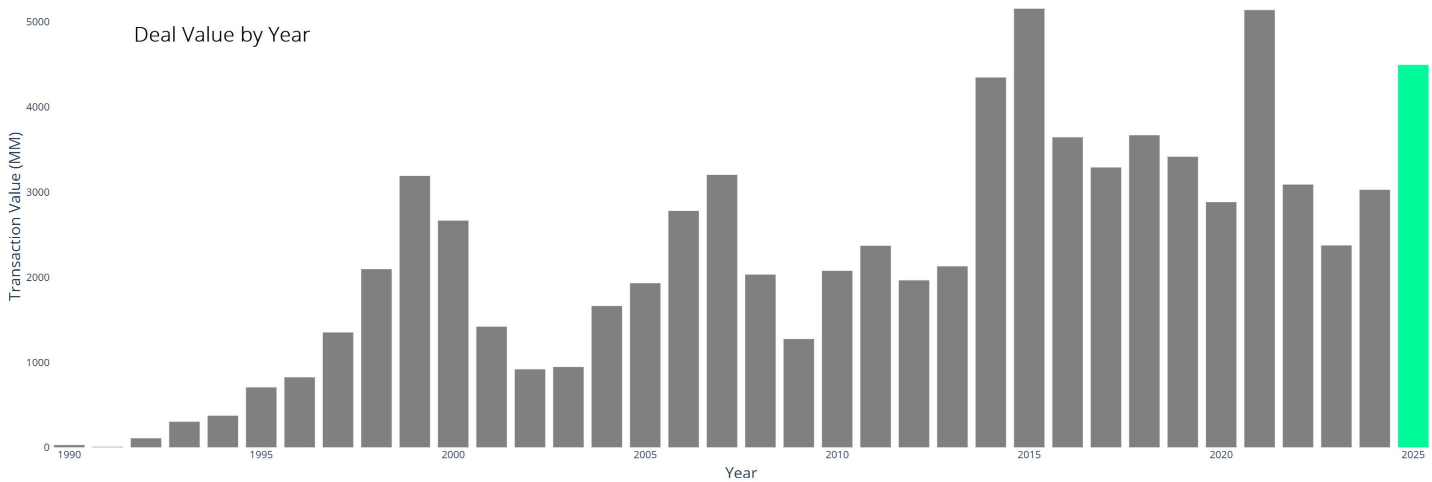
Southeastern Asset Management

Our last note on Warren Buffett did not include another one of our favorite moments from him: Berkshire's 1989 shareholder letter comments on "the institutional imperative," his term for why public companies too often ignore a rational Business, People, Price approach to capital allocation and instead overpay in M&A (mergers and acquisitions). What he wrote then remains true today. This week even had the headline: "EU cross-border banking deals jump to highest since 2008." 2025 was a big year for M&A, which has historically been a sign of a toppy market.



Source: FactSet

While it is easy to call out bad M&A after the fact, we have learned some lessons (the hard way) on how to distinguish bad from good M&A before it is too late. Let us first acknowledge that most M&A is potentially dangerous for the buyer, as many studies have shown. The seller knows more than the buyer, and the institutional imperative leads to too much of the wrong kind of rationalization from the buyer. Two kinds of bad deals stand out: 1) When a company beats other bidders at a time of market optimism and takes on excessive leverage to fund a deal, look out. This warning applies even when a management team might have built up "credibility" that they spend in an acquisition like this. Some of our previous mistakes have come from such situations, and in the spirit of "praise in public, criticize in private," we will leave it at that; 2) The perils of "diworsification" are well-established, so strategic left turns that do not make sense regardless of price show that the company has valid fears about its core business. Think back to the dreaded "cross-border banking deals" referenced above. Additionally, deals like this can show that the people at a company might 1) not understand the importance of value per share vs. price per share and/or 2) do know what they are worth, but it's a lower number than we previously thought.

Sometimes M&A can make sense for the buyer. We get interested when the right mix of the following criteria are met: 1) management teams and boards who think and act like long-term owners are on the case; 2) the acquired asset fits with the company's existing strategy; 3) the deal process is complex, leading to a lack of other bidders; 4) the company post-deal is not excessively leveraged. One example that comes to mind is when we owned Vail Resorts in the early 2010s, and the company pounced on the opportunity to do a 2-step transaction to create a large resort in Utah after an asset's owner forgot to mail in a rent check (yes, really!). Interestingly, the great results from this deal spurred what turned out to be some less good deals by Vail over the next 5-10 years after we had sold. Another deal we benefited from was when we invested in Liberty Media's 2016 iteration, which was basically a large amount of cash and 30% of Live Nation. Shortly after we invested, John Malone and team purchased Formula One from a long-in-the-tooth private equity owner that was understandably tired of it (we might owe Bernie Ecclestone a thank you). Liberty brought in all-time great Southeastern partner Chase Carey to sort things out, and Liberty's $8 billion price now trades at $35 billion. We remain partnered with Malone today at both new-in-2025 holding GCI Liberty and 2020-purchase Atlanta Braves Holdings.

Now for some examples of current investees who are working to reverse previously misguided M&A from before we invested. We are thrilled that Steve Cahillane, our great CEO partner from Kellogg/Kellanova, is now CEO at Kraft Heinz.

The mid-2010s merger of Kraft and Heinz never should have happened (a rare miss that Buffett has acknowledged), but now Steve and Chairman John Cahill are getting the company back on track. While we still think this company could be structured differently at some point, they have paused a planned split of the company between its relatively strong "Taste Elevation" businesses (Heinz, Philadelphia Cream Cheese and others that are likely worth a teens EBITDA multiple) and its less good meat and cheese businesses (they own other quality businesses in between these extremes like Ore-Ida). We anticipate seeing smart asset sales and better operations in the near term. Sometimes an existing team can see the light and start making changes themselves, helped along by engaging with us and others. For example, Delivery Hero is now more of a seller than a buyer after a period of excessive M&A. An IPO of their Middle East business and an attempted sale of their Taiwan business to Uber (blocked by regulators) are encouraging signs, but the company should do more. Jollibee's recent decision to split up its confusing-to-the-market (one of the reasons we invested originally) mix of assets into two companies is another good sign, in our opinion. We feel that the core Jollibee brand is strong, both in its home market of the Philippines and around the world. We are pleased to see the Tan family take shareholder-friendly steps that can lead to more focus and growth in value per share.

Sometimes a deal can actually be good for both parties, and the recently closed merger of our timberland investees Rayonier and PotlatchDeltic is one such example. This win-win combination creates a better Business that has a stronger asset base operating over fewer duplicate costs. Timberland is a unique industry where being geographically diversified across the USA increases optionality and therefore the value of the existing assets: if log and/or pulp prices are weak in a certain area, then simply let the trees keep growing there, while cutting in another region where prices are better. Acreage has also historically been a great store of value with increasing uses for land beyond growing trees, but this is missed today when the market cares too much about short-term pulp pricing and housing trends impacting quarterly earnings, all at a time of excessive interest in less useful assets like gold and crypto. We are excited to stay partnered with this group of People. CEO Mark McHugh comes from the Rayonier side where he has been making great moves such as selling multiple non-core assets while repurchasing stock. Executive Chairman Eric Cremers from the PotlatchDeltic side will lead a refined, merged board. They understand value per share and are now back on offense after having to pause share repurchase during the deal process. The Price is attractive, as the public markets have a hard time figuring out what to do with this company. Weyerhaeuser (which is qualitatively inferior to the newly merged Rayonier+PotlatchDeltic) is now the only other public timber REIT in the USA, so the relative-value-driven world of the sellside and many institutional investors (let alone autopilot passive/sector ETF holders) is baffled. We do our own bottom-up work, informed by decades of experience in this industry, to get to a value for the newco (which is yet to be named as we type) that is significantly above the current market price. We could see this company being better off under private ownership, and if one of the big tech companies wants to prove it cares about doing right by the environment instead of engaging in a crazy AI spending race, they should buy and conserve these 4 million+ acres.

Thank you for reading. We believe the best way to connect is through meaningful discussions about companies, so please reach out to info@seasset.com if you would like to continue the conversation.