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Buffett Sees Value in Beaten-Down USG

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WARREN BUFFETT'S BERKSHIRE HATHAWAY is adding to its stake in USG after investors razed the building-materials stock amid concerns over the housing market.

Berkshire Hathaway spent more than $17.1 million to purchase 371,200 shares of USG in the open market on Oct. 4, according to a Securities and Exchange Commission filing late Friday. The shares were priced at $46.10.

Berkshire Hathaway increased its holdings to 17.07 million shares, or a 19% stake.

Lon Juricic, founder of StreetInsider.com, says that Buffett, the chief executive of Berkshire Hathaway and America's most famous stock investor, "has been quite aggressive with the stock being that the whole group is down because of the homebuilding and housing bubble.

"It shows that he has quite a lot of faith in USG; that he sees something there that maybe a lot of other people don't," he adds.

Shares of USG, which invented wallboard and ceiling tile, rallied to a record high of $94.22 on April 25 on a string of robust earnings and news that it reached a settlement in asbestos litigation that sent the company into Chapter 11 bankruptcy in June 2001. USG emerged from bankruptcy in June 2006.

But the stock has plunged 48% since then, buffeted by lower wallboard volume and prices depressed by a slowdown in new homebuilding.

Clearly, Buffett expects to "get a good return on his investment and certainly his involvement in the company will keep a floor under the stock," says Ben Silverman, director of research at InsiderScore.com.

Unlike activist shareholders such as Carl Icahn, Buffett "takes a more hands off approach… looking at undervalued situations," Juricic says.

"We're pleased to have Berkshire Hathaway as a shareholder and we appreciate their support," says USG spokesman Robert Williams. Despite its large stake though, he adds that "Berkshire Hathaway is at arms length like other shareholders."

Indeed, despite owning nearly a fifth of USG's outstanding shares, Berkshire Hathaway has been a passive investor. That's because USG was already a healthy and profitable company before it sought out bankruptcy court to resolve its asbestos litigation for products sold two decades earlier, says Williams.

Unlike other shareholders, however, Berkshire Hathaway has the right to hold up to 40% of USG's outstanding shares based on a backstop agreement. USG announced on June 30 that it planned to help fund its asbestos settlement by raising $1.8 billion through a rights offering of 44.9 million shares.

Under the arrangement, every USG shareholder could purchase one additional share at $40 for every share they owned (compared to the going market rate of around $71). If all shareholders did not exercise this option, Berkshire was required to buy up the remaining shares based on the backstop agreement. USG paid Berkshire Hathaway a $67 million fee for this commitment.

Berkshire increased its stake to nearly 15.96 million shares, or 17.8%, as of Aug. 25 following the rights offering, up from 13.47 million shares, or 15%.

Michael Painchaud, managing director of research at Market Profile Theorems, says that its "befuddling" that insider sentiment at USG and its peers in building materials, such as Eagle Materials, is so strong considering the housing market and analysts' bearish sentiment. (See Inside Scoop, "Buys Reinforce Outlook for Eagle Materials," Sept. 20, 2006)

Still, he says, Berkshire Hathaway's recent willingness to pay the market price could be a harbinger of good things for the stock. "We found that value managers, in terms of their stock selection timing, tend to be about 60 to 90 days early."

Painchaud says robust insider selling in May preceded a precipitous drop in the stock. Six top executives, including Chief Executive William Foote, grossed $11.27 million by selling 105,500 shares in the open market, according to Thomson Financial data.

Given this backdrop, Harris Hall, director of equity research at Singular Research, says USG is a "value company" that boasts 20% operating margins, 25% profit margins, an incremental increase in expenses and strong revenue growth.

"It's a pretty cheap company," says Hall. "It's got some good profitability metrics and, not surprising, it's a classic Buffett acquisition."